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SUBSIDIZED OPERATORS IN DOMESTIC TRADE

HEARING

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

S. 2170

TO PRESCRIBE THE CONDITIONS UNDER WHICH CONTRACTORS RECEIVING OPERATING-DIFFERENTIAL SUBSIDY OR THEIR AFFILIATES MAY ENGAGE IN COASTWISE OR INTERCOASTAL TRADE

MAY 16, 1990

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CONTENTS

Page

Opening statement by Senator Breaux ... 1
Opening statement by Senator Inouye ... 2
Opening statement by the Chairman ... 4
Text of S. 2170 ... 6

LIST OF WITNESSES

Barer, Stanley H., chairman of the board, Totem Resources Corp.; accompanied by Alan Butchman, counsel ... 73
  Prepared statement ... 75
  Questions of Senator Inouye and the answers ... 91
  Questions of Senator Breaux and the answers ... 95
Mulholland, C. Bradley, president and chief operating officer, Matson Navigation Co., Inc.; accompanied by R.J. Pfeiffer, chairman of the board and CEO; and Michael B. Esch, counsel ... 27
  Prepared statement ... 30
  Questions of Senator Breaux and the answers ... 45
  Questions of Senator Inouye and the answers ... 56
Patton, Robert, Deputy Chief Counsel, Maritime Administration; accompanied by Richard Bowman, Associate Administrator ... 11
  Prepared statement ... 13
Rhein, Timothy J., president and chief operating officer, American President Domestic, Inc.; accompanied by David V. Ainsworth, vice president and general counsel ... 112
  Questions of Senator Inouye and the answers ... 116
  Questions of Senator Breaux and the answers ... 128
Stocker, John J., president, Shipbuilders Council of America ... 145
  Prepared statement ... 147
  Questions of Senator Breaux and the answers ... 153
Verdon, William P., president, United Shipowners of America ... 136
  Questions of Senator Breaux and the answers ... 138
  Questions of Senator Inouye and the answers ... 176

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Mandl, Alex, chairman and CEO, Sea-Land Service, Inc., statement ... 172
Seaman, Tobias E., president, National Association of Shippers Consignees and Consumers for Maritime Affairs, statement ... 162

SUBSIDIZED OPERATORS IN DOMESTIC TRADE

WEDNESDAY, MAY 16, 1990

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON MERCHANT MARINE,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room SR–253, Russell Senate Office Building, Hon. John B. Breaux (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Harold Creel, staff counsel; John Moran and Earl Comstock, minority staff counsels.

OPENING STATEMENT OF SENATOR BREAUX

Senator BREAUX. The subcommittee will please come to order.

This afternoon we are here to hear testimony on the bill S. 2170, introduced by our colleague Senator Inouye. The bill would change the standard used by the Secretary of Transportation in determining whether to permit U.S.-flag ship operators that receive operating-differential subsidy to enter the domestic trades.

The bill would also prohibit an affiliate of an operator that receives ODS from using vessels built with construction differential subsidy once the vessel reaches 25 years of age.

The focus today will not be on ODS reform generally, which will be the subject of another hearing later this year, but on the limited issues that I have just mentioned. The idea of ODS reform has been around for a long time, but there has been no real progress so far in reforming the program, certainly since I have been here.

I certainly hope that we can move closer to accomplishing some reform in this area when we look at those issues in our subcommittee.

It is my understanding there are certainly strong sentiments on all sides of this proposed legislation. There is currently an application at MarAd that, if granted, would allow the same type of operations that are restricted by this legislation. Proponents of that application obviously oppose the legislation.

Carriers that operate exclusively in the domestic trade favor the legislation because it would place further restrictions on subsidized carriers entering the domestic trade. Other carriers believe that the proposed legislation does not go far enough in prohibiting domestic trade by subsidized carriers, while yet even others believe that it does not go far enough in permitting subsidized operators to enter the domestic trade.

This divergency of views should make for an informative hearing.

Because of the pending application at MarAd that addresses some of the issues and some of the parties before us today, we must be careful not to intrude on the integrity of that ongoing proceeding. We are not, however, precluded from discussing the procedures followed by MarAd in making the determinations regarding entry into the domestic trades or other issues that do not discuss the facts and the parties to that proceeding.

I welcome all of our witnesses to our subcommittee this afternoon. Before we introduce our witnesses, I will ask the author of the legislation, the distinguished Senator Inouye, for any comments he may have.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. I wish to thank my distinguished Chairman for scheduling hearings on S. 2170, a bill which would amend section 805 of the Merchant Marine Act. That section prescribes when ODS recipients and their affiliates may operate in our Jones Act trades.

There has been an increasing tendency by MarAd to free ODS recipients from operating restrictions which the law imposes upon them as conditions of subsidy. This trend coupled with apparent inconsistent statements by the agency has led to confusion among the shipping public, non-subsidized carriers, and subsidized carriers as to when subsidized operators may receive section 805 permission to operate in Jones Act trades, where existing service is adequate.

Most recently, for example, after saying that *States Steamship* was a "landmark mixed service case" under Section 805, an Administrative Law Judge proceeded to characterize what the Secretary of Commerce and the District Court had to say about Section 805 and adequate service in that case, as, in effect, a "mistake," and "something neither meant." To compound the confusion further, MarAd has not, to my knowledge, ever granted section 805 permission for mixed service where existing service is adequate.

As an elected representative of an off-shore state which is dependent upon ocean transportation for 98 percent of the goods and commodities which must be obtained from the mainland, I am especially concerned with this confused situation because of its potential to destabilize that trade.

The Merchant Marine Act of 1936, recognizes that, in some limited cases, it might further the objectives of our national maritime policy if the general rule of allowing subsidy only for foreign voyages were relaxed, and subsidized operators where permitted to divert their resources from the task for which they were subsidized, and compete with our Jones Act fleet.

Accordingly, sections 506 and 605(a) of the Act set out very limited exceptions to the general rule of allowing subsidy for foreign voyages only; and section 805(a) further requires that domestic calls, otherwise permissible under section 506 and 605(a), must not result in unfair competition for exclusively domestic operators, or prejudice the objects and policy of the Act, or divert subsidy funds to the domestic operation.

Manifestly it would be impossible for Congress to administer all of the laws it enacts and the programs which are created by them.

Usually, we legislate general standards, and leave it to the administrative agencies to flesh them out, or particularize them, through policies, rules, and decisions. While this necessarily gives the agencies broad authority, that authority is not unrestricted. Agency policies and actions must be grounded in and reflected to statutory source and the policy those statutes are meant to effectuate.

Nevertheless, because agencies have such wide discretion, it is not unusual for one to exceed its discretion, albeit unwittingly, to achieve a result which the agency perceives to be in the public interest. When this occurs either the Courts or Congress, or both, have acted to ensure that the law is administered to implement the policy as Congress intended. Sometimes Congress even acts before the administrative and judicial processes have been exhausted. A case in point was a proposed rule by the Secretary of Transportation to permit tankers built for our international trades to repay CDS so they could compete in the Jones Act trades. On several occasions Congress enacted legislation to prohibit the Secretary from implementing such a rule.

In those instances, provisions in Appropriations measures prohibited the use of any funds from being used to implement a rule for the repayment of CDS, because Congress felt that such a rule "would allow owners of vessels built with CDS and therefore restricted to foreign trades to repay their subsidies and enter an already overcrowded domestic trade". Enforcement of such a rule, Congress said, would also "damage an already fragile industry and would adversely impact the domestic tanker fleet which is vital to our national security interests". So Congress has legislated to affect a previously taken administrative action when it felt that action did not reflect national maritime policy; and we have done so even though private parties may have relied on a contrary notion of what that policy was when they urged their position before an agency.

The Court of Appeals also remanded an effort by the Secretary of Transportation to adopt a CDS payback rule.

In its opinion the Court said:

> The Secretary [fails] to link the policies served by this rule to the objectives set out in the Merchant Marine Act . . . her account focuses on non-statutory criteria that favor this rule, such as lower transportation costs, collateral fiscal benefits, and more "efficient" use of the fleet . . . [While] the Secretary is certainly free to consider factors that are not mentioned explicitly in the governing statute, she is not free to substitute new goals in place of the statutory objectives without explaining how these actions are consistent with her authority under the statute. (*Independent U.S. Tanker Owners Committee* v. *Dole*, 809 F.2d.847 [D.C. Cir. 1989]).

I had expected that the Maritime Administrator would be testifying today because, as the principal spokesman for the Agency, he would be in the best position to tell the Subcommittee precisely how MarAd interprets Congressional policy underlying the restrictions in section 805 when application is made for mixed service in a domestic trade where existing service is adequate.

Just as importantly, Captain Leback has recused himself from the section 805 case pending before his Agency, so he would have been able to respond freely and fully to my questions without fear of depriving any of the parties in that case of procedural due process (*The Pillsbury Company.* v. *Federal Trade Commission*, 354 F.2d 952 (1966)).

Regrettably, however, Captain Leback is in Moscow on maritime negotiations and is therefore unavailable at this time. It is not my intention to run afoul of *Pillsbury*, but I recognize that could occur. So, I would say to the MarAd witness, if you feel that any of my questions raise issues under *Pillsbury*, please do not hesitate to say so.

If there are any questions, it seems to me that Capitain Leback or another spokesperson for DOT not restricted by *Pillsbury* could respond expeditiously in writing, if that is agreeable to my Chairman and the Subcommittee.

Mr. Chairman, I again wish to commend you for giving the Subcommittee an opportunity to consider this important matter in such timely fashion.

I just have a few additional words about something which happened in the last 24 hours. Although Sea-Land has chosen not to testify on this measure, I have been informed today that it is putting several more vessels into the Mainland-Hawaii-Pacific trade. I believe there will be five vessels.

As an unsubsidized carrier, of course, Sea-Land does not need section 805 permission to do so. It does, however, seem that the deployment of older, additional CDS-built ships could have an inhibiting effect on new construction in U.S. yards.

While Sea-Land, as an unsubsidized carrier, has every right to enter this trade, subject of course to pro-rata CDS payback under 506, its action today, in my opinion, emphasizes the disastrous consequences that may ensue if MarAd relaxes the restrictions of section 805 to allow subsidized carriers to enter a domestic trade which is adequately served.

As it is, the mainland-Hawaii trade would be seriously overtonnaged if APL is allowed to enter. As a result of Sea-Land's announcement, a serious situation would be made worse. Moreover, it produces an anti-competitive result because existing unsubsidized carriers will be inhibited from expanding their service.

So Mr. Chairman, in my judgment what has happened today underscores the need for S. 2170, if we are to preserve our domestic trades. And I thank you very much, sir.

Senator BREAUX. Thank you very much, Senator, for your opening statement and your comments on the legislation, which you are of course the author of.

I have an opening statement that Senator Hollings would like to have included in the record:

[The statement and bill follow:]

OPENING STATEMENT BY THE CHAIRMAN

The purpose of the hearing today is to hear testimony on S. 2170, a bill introduced by Senator Inouye which would amend the Merchant Marine Act of 1936 as it pertains operating differential subsidy (ODS). The bill would change the conditions under which contractors receiving ODS or their affiliates may engage in coastwise or intercoastal trade.

Before we begin, I would like to welcome all of the witnesses that will testify today. This is a complicated issue and I believe that the more that you can help educate us in this area the better off we all are. I would also caution all of the witnesses that many of the facts and issues we will be discussing today are the subject of an administrative proceeding that is occuring at the Maritime Administration.

We would not want, in today's hearing, to prejudice the parties to that proceeding nor influence the Maritime Administration in its decision-making process.

Once again, welcome to the Subcommittee. We look forward to hearing your testimony.

101st CONGRESS
2d Session

S. 2170

To prescribe the conditions under which contractors receiving operating-differential subsidy or their affiliates may engage in coastwise or intercoastal trade.

IN THE SENATE OF THE UNITED STATES

February 26 (legislative day, January 23), 1990

Mr. Inouye introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

---

A BILL

To prescribe the conditions under which contractors receiving operating-differential subsidy or their affiliates may engage in coastwise or intercoastal trade.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. The third sentence of section 805(a) of the Merchant Marine Act, 1936 (46 App. U.S.C. 1223(a)), is amended to read as follows: "The Secretary of Transportation, with respect to proposed domestic operation of bulk vessels, shall not grant any such application if the Secretary of Transportation finds it will result in unfair competition to any person, firm, or corporation operating exclusively in the coastwise or intercoastal service or that it would be prejudicial to the objects and policy of this Act.".

SEC. 2. Section 805(a) of the Merchant Marine Act, 1936 (46 App. U.S.C. 1223(a)), is amended by inserting immediately after the first paragraph the following:

"Applications by a common carrier in interstate or foreign commerce for written permission under this subsection shall disclose the nature and scope of operations proposed to be conducted in coastwise or intercoastal trade. The Secretary of Transportation shall hold a hearing on applications by a common carrier in interstate or foreign commerce to operate a proposed mixed foreign and domestic service to receive evidence on the quantity and quality of the existing service, a description of the proposed service and its effect on existing service, and conditions that should be contained in any grant of written permission for the proposed mixed service. After the hearing under this subsection on proposed mixed service, the Secretary of Transportation may grant such application if the Secretary of Transportation finds that the existing service provided in the coastwise or intercoastal trade by all vessels is inadequate: *Provided,* That such grant shall contain any express conditions necessary to insure that the proposed mixed service (1) will not be prejudicial to the objects and policy of this Act, (2) will not result in any unfair competition to any person, firm, or corporation operating a service exclusively in the coastwise or intercoastal trade, and (3) will not result in the applicant's service in the coastwise or intercoastal trade being supported, directly or indirectly, by any money paid by the United States to a contractor under title VI of this Act to subsidize operations by that contractor in the United States foreign commerce.

"In a hearing under this subsection with respect to proposed affiliated service by a common carrier in interstate or foreign commerce, the Secretary of Transportation shall not grant the application unless, after considering the entire record developed during the hearing, the Secretary of Transportation finds that (A) grant of the application will not result in the applicant's service in the coastwise or intercoastal trade being supported, directly or indirectly, by any money paid by the United States to a contractor under title VI of this Act to subsidize operations by that contractor in the United States foreign commerce, (B) grant of the application would not otherwise result in unfair competition to any person, firm, or corporation operating exclusively in the coastwise or intercoastal trade or be prejudicial to the objects and policy of this Act, and (C) that the domestic service proposed by the affiliate of the subsidy contractor will not be provided with any vessels over twenty-five years old that were built with construction-differential subsidy.".

SEC. 3. The last paragraph of section 805(a) of the Merchant Marine Act, 1936 (46 App. U.S.C. 1223(a)), is amended by adding at the end the following: "Any written permission granted under this subsection to operate in the coastwise or intercoastal trade may be revoked by the Secretary of Transportation following determination that such a violation has occurred.".

SEC. 4. Section 805 of the Merchant Marine Act, 1936 (46 App. U.S.C. 1223), is amended by adding at the end the following new subsection:

"(g) As used in this section—

"(1) The term 'affiliated service' means and coastwise or intercoastal service subject to this section other than a mixed service.

"(2) The term 'common carrier in interstate or foreign commerce' means a person holding itself out to the general public to provide transportation by water of passengers or cargo in interstate or foreign commerce of the United States that (A) assumes responsibility for the transportation from the part or point of receipt to the port or point of destination and (B) utilizes, for all or part of that transportation, a vessel operating on the high seas.

"(3) The term 'hearing' means an adjudication conducted pursuant to the requirements of section 554 of title 5, United States Code.

"(4) The term 'mixed service' means a voyage described in section 605(a) of this Act.".

SEC. 5. The amendments made by this Act relating to the payment of operating-differential subsidy to operators of common carriers in interstate or foreign commerce shall be applicable to their contracts in effect on or after the date of enactment of this Act. Within one hundred and eighty days after such date of enactment, the Secretary of Transportation shall initiate a hearing to determine whether the mixed or affiliated service by any such common carrier is in accordance with the provisions of section 805 of the Merchant Marine Act, 1936 (46 App. U.S.C. 1223), as amended by this Act. If the Secretary finds after such hearing that the service is not in compliance, he shall issue an order prescribing conditions necessary to bring it into compliance. Failure to comply with any conditions prescribed by the Secretary shall result in revocation of any written permission previously granted under subsection (a) of such section 805, except that any finding of noncompliance under this section shall not constitute a misdemeanor under the last paragraph of such subsection (a).

○

Senator **Breaux**. We welcome our first witness, on behalf of the Administration, of course, Mr. Robert Patton, who is Deputy Counsel for the Maritime Administration, who is accompanied by Dick Bowman. We welcome you and look forward to your statement.

STATEMENT OF ROBERT PATTON, DEPUTY CHIEF COUNSEL, MARITIME ADMINISTRATION, ACCOMPANIED BY RICHARD BOWMAN, ASSOCIATE ADMINISTRATOR

Mr. **Patton**. Thank you, Mr. Chairman.

With your permission, I will just summarize my statement.

Senator **Breaux**. Without objection.

Mr. **Patton**. Mr. Chairman, members of the Subcommittee on Merchant Marine, it is my pleasure to appear before you this afternoon to present the Administration's views on S. 2170, a bill to prescribe the conditions under which contractors receiving operating-differential subsidy may engage in coastwise or intercoastal trade.

The Administration appreciates the desire to assure an even playing field between the United States-flag domestic and foreign trade fleets. It cannot agree, however, that the best means of providing that assurance is to establish three standards for permission for subsidized carriers to participate directly or indirectly in domestic trade.

The Administration believes that the existing statutory authority that makes no distinction among different types of services provides a fair and equitable basis for permission.

S. 2170 provides separate standards for approval of applications: (1), by bulk vessel operators; (2), by a common carrier in interstate or foreign commerce that proposes a mixed foreign and domestic service that includes one of the four types of voyages described in 605(a) of the 1936 Act; and (3), by such a common carrier that proposes a so-called affiliated service.

The standards for the three types of applications all essentially require a finding that the grant would not result in unfair competition to any interested person operating exclusively in the coastwise or intercoastal trade, or not be prejudicial to the objects and policy of the Act. This standard is the present law.

For mixed service, S. 2170 would also require: (1), a finding that the existing service provided in the coastwise or intercoastal trade by all vessels is inadequate; and (2), a condition ensuring that the grant would not result in the proposed service being supported directly or indirectly by ODS.

As is well known and as has been mentioned, there is pending before the agency a mixed service application by American President Lines to serve Hawaii with its California and-or Northwest container ship services to the Far East. Since the initial decision by the administrative law judge is under review by the Maritime Administration, it is inappropriate for me to discuss the merits of that pending proceeding, and nothing stated herein is intended to take a position on such merits.

However, I will mention that the range of the legal standards argued by the litigants covers the extent to which, if any, inadequacy is included under present law.

With respect to barring ODS support for domestic operation, the Administration believes that this requirement is essentially unnecessary. Section 605(a) of the 1936 Act now generally prohibits the payment of ODS for operations in the coastwise or intercoastal trades except under four circumstances involving a foreign voyage. In these circumstances, the subsidy payment for the entire voyage must be reduced by a proportion based on gross revenue that the domestic service earned relative to the gross revenue derived from the entire voyage.

The Administration believes that this and other provisions in current law are adequate to prevent the direct or indirect payment of ODS for domestic service.

For affiliated or other liner services, S. 2170 would also add the requirement that the proposed domestic service by the affiliate of the subsidy contractor not be provided with any CDS-built vessels over 25 years old. Resolution of such concerns should not be separately addressed in legislation pertaining solely to section 805(a), but rather in the overall context of the entire range of maritime policy direction.

Finally, for both mixed service and other liner services, the Secretary would be required under S. 2170 to initiate a hearing to determine whether the present mixed or affiliated service by a common carrier complies with section 805(a) as amended by this bill, and the Secretary must issue an order prescribing conditions necessary to bring any noncompliant operator into compliance.

The Administration is strongly opposed to any retroactive application of new standards in this bill and believes if legislation is pursued that existing permissions under current law should be honored.

This concludes the summary of my statement, Mr. Chairman, and I will be pleased to answer any questions that you or other members of the subcommittee may have.

[The statement follows:]

STATEMENT OF ROBERT J. PATTON, JR. DEPUTY CHIEF COUNSEL OF THE MARITIME ADMINISTRATION IN THE DEPARTMENT OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE ON MERCHANT MARINE OF THE SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION, ON S. 2170, A BILL TO PRESCRIBE THE CONDITIONS UNDER WHICH CONTRACTORS RECEIVING OPERATING-DIFFERENTIAL SUBSIDY OR THEIR AFFILIATES MAY ENGAGE IN COASTWISE OR INTERCOASTAL TRADE.

MAY 16, 1990

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE ON MERCHANT MARINE, IT IS MY PLEASURE TO APPEAR BEFORE YOU THIS MORNING TO PRESENT THE ADMINISTRATION'S VIEWS ON S. 2170, A BILL TO PRESCRIBE THE CONDITIONS UNDER WHICH CONTRACTORS RECEIVING OPERATING-DIFFERENTIAL SUBSIDY (ODS), OR, IN SOME INSTANCES RELATED PERSONS, MAY ENGAGE IN COASTWISE OR INTERCOASTAL TRADE.

THE BILL FOCUSES ON THE AREA OF OVERLAP BETWEEN THE UNITED STATES-FLAG FOREIGN AND DOMESTIC FLEETS. IT ESTABLISHES THREE DIFFERENT TYPES OF PERMISSION, DEPENDING ON THE PROPOSED SERVICE, THAT A SUBSIDIZED UNITED STATES-FLAG OPERATOR ENGAGED IN UNITED STATES FOREIGN COMMERCE MUST OBTAIN TO ENGAGE DIRECTLY OR INDIRECTLY IN THE UNITED STATES DOMESTIC TRADE, EVEN WITH PROPORTIONAL PAYBACK OF OPERATING AND CONSTRUCTION SUBSIDY.

THE ADMINISTRATION SUPPORTS THE JONES ACT AND APPRECIATES THE DESIRE TO ASSURE AN EVEN PLAYING FIELD BETWEEN THE UNITED STATES-FLAG DOMESTIC AND FOREIGN TRADE FLEETS. THE ADMINISTRATION CANNOT AGREE, HOWEVER, THAT THE BEST MEANS OF PROVIDING THAT ASSURANCE IS TO ESTABLISH THREE DISTINCT STANDARDS FOR PERMISSION FOR SUBSIDIZED CARRIERS TO PARTICIPATE DIRECTLY OR INDIRECTLY IN DOMESTIC TRADE. THE ADMINISTRATION BELIEVES THAT

EXISTING STATUTORY AUTHORITY THAT MAKES NO DISTINCTION AMONG DIFFERENT TYPES OF SERVICE PROVIDES A FAIR AND EQUITABLE BASIS FOR PERMISSION.

THREE PERMISSIONS

BULK OPERATIONS

S. 2170 PROVIDES THAT, FOR APPLICATIONS WITH RESPECT TO PROPOSED DOMESTIC OPERATION OF BULK VESSELS, THE STANDARDS OF THE PRESENT LAW, SECTION 805(a) OF THE 1936 ACT (46 APP. U.S.C. 1223), WOULD APPLY. THAT PROVISION PROHIBITS OPERATION IN THE DOMESTIC INTERCOASTAL OR COASTWISE SERVICE BY OPERATORS RECEIVING ODS, OR ANY OF THEIR HOLDING COMPANIES, SUBSIDIARIES, AFFILIATES, OR ASSOCIATES, WITHOUT WRITTEN PERMISSION OF THE SECRETARY OF TRANSPORTATION. ANY PERSON HAVING AN INTEREST IN SUCH AN APPLICATION TO OPERATE IN DOMESTIC TRADE IS PERMITTED TO INTERVENE AND THE SECRETARY IS REQUIRED TO HOLD A HEARING FOR THE APPLICANT AND THE INTERESTED INTERVENORS. THE SECRETARY SHALL NOT GRANT THE APPLICATION IF IT IS FOUND THAT THE PROPOSED DOMESTIC TRADE WOULD RESULT IN UNFAIR COMPETITION TO ANYONE OPERATING EXCLUSIVELY IN THE COASTWISE OR INTERCOASTAL SERVICE, OR THAT IT WOULD BE PREJUDICIAL TO THE OBJECTS AND POLICY OF THE 1936 ACT.

THE PRESENT LAW REQUIRES A "HEARING" ON CONTESTED SECTION 805(a) APPLICATIONS, BUT IT HAS NOT BEEN ESTABLISHED THAT SUCH HEARING MUST BE A FORMAL, TRIAL-TYPE HEARING IN ACCORDANCE WITH SECTION 554 OF THE ADMINISTRATIVE PROCEDURE ACT, 5 U.S.C. 554

(APA). AS A PRACTICAL MATTER, SUCH A HEARING HAS BEEN EXTENDED. S. 2170 WOULD COMPEL SUCH A HEARING.

MIXED SERVICE

SECTION 2 OF THE BILL WOULD REQUIRE MANDATORY APA HEARINGS ON AN APPLICATION BY A COMMON CARRIER IN INTERSTATE OR FOREIGN COMMERCE THAT PROPOSES A MIXED FOREIGN AND DOMESTIC SERVICE. A PROPOSAL WOULD BE TERMED "MIXED SERVICE" WHEN IT INCLUDED A VOYAGE DESCRIBED IN SECTION 605(a) OF THE 1936 ACT (46 APP. U.S.C. 1175), THAT IS A ROUND-THE-WORLD VOYAGE; A ROUND VOYAGE FROM THE WEST COAST OF THE UNITED STATED TO A EUROPEAN PORT OR PORTS; A ROUND VOYAGE FROM THE ATLANTIC COAST TO THE ORIENT THAT INCLUDES INTERCOASTAL PORTS OF THE UNITED STATES; OR A VOYAGE IN FOREIGN TRADE ON WHICH THE VESSEL MAY STOP AT HAWAII OR AN ISLAND POSSESSION OR TERRITORY OF THE UNITED STATES.

AT THE HEARING ON THE PROPOSED MIXED SERVICE, THE SECRETARY WOULD RECEIVE EVIDENCE ON THE QUANTITY AND QUALITY OF THE EXISTING SERVICE, A DESCRIPTION OF THE PROPOSED SERVICE AND ITS EFFECT ON EXISTING SERVICE, AND THE CONDITIONS THAT SHOULD BE CONTAINED IN ANY GRANT OF WRITTEN PERMISSION FOR THE PROPOSED MIXED SERVICE. AFTER THE HEARING, THE SECRETARY COULD GRANT AN APPLICATION ONLY UPON FINDING THAT THE EXISTING SERVICE PROVIDED IN COASTWISE OR INTERCOASTAL TRADE BY ALL VESSELS IS INADEQUATE.

IF AN APPLICATION IS GRANTED, S. 2170 PROVIDES THAT THE GRANT OF PERMISSION MUST CONTAIN ANY EXPRESS CONDITIONS NECESSARY TO INSURE THAT THE PROPOSED MIXED SERVICE WOULD NOT BE PREJUDICIAL TO THE OBJECTS AND POLICY OF THE 1936 ACT, WOULD NOT

RESULT IN ANY UNFAIR COMPETITION TO ANY PERSON OPERATING EXCLUSIVELY IN THE COASTWISE OR INTERCOASTAL TRADE, AND WOULD NOT RESULT IN THE PROPOSED MIXED SERVICE BEING SUPPORTED, DIRECTLY OR INDIRECTLY, BY ODS.

OTHER LINER SERVICE

STILL ANOTHER STANDARD IS CREATED FOR A PROPOSED "AFFILIATED SERVICE" BY A COMMON CARRIER IN INTERSTATE OR FOREIGN COMMERCE. "AFFILIATED SERVICE" IS DEFINED TO MEAN COASTWISE OR INTERCOASTAL SERVICE OTHER THAN MIXED SERVICE BY A COMMON CARRIER IN INTERSTATE OR FOREIGN COMMERCE. UNDER THESE PROVISIONS, THE SECRETARY COULD NOT GRANT AN APPLICATION UNDER SECTION 805(a) UNLESS, AFTER CONSIDERING THE ENTIRE HEARING RECORD, A FINDING IS MADE THAT (A) GRANTING THE APPLICATION WOULD NOT RESULT IN THE APPLICANT'S PROPOSED SERVICE BEING SUPPORTED, DIRECTLY OR INDIRECTLY, BY ODS; (B) GRANTING THE APPLICATION WOULD NOT OTHERWISE RESULT IN UNFAIR COMPETITION TO ANY PERSON OPERATING EXCLUSIVELY IN THE COASTWISE OR INTERCOASTAL TRADE OR BE PREJUDICIAL TO THE OBJECTS AND POLICY OF THE 1936 ACT; AND (C) THE PROPOSED DOMESTIC SERVICE BY THE AFFILIATE OF THE "SUBSIDY CONTRACTOR" WOULD NOT BE PROVIDED WITH ANY VESSELS OVER 25 YEARS OLD THAT WERE BUILT WITH CONSTRUCTION DIFFERENTIAL SUBSIDY (CDS).

THUS, THE STANDARDS FOR THE THREE TYPES OF APPLICATIONS ALL ESSENTIALLY REQUIRE FINDING THAT THE GRANT WOULD NOT RESULT IN UNFAIR COMPETITION TO ANY INTERESTED PERSON OPERATING EXCLUSIVELY IN THE COASTWISE OR INTERCOASTAL SERVICE, OR NOT BE PREJUDICIAL

TO THE OBJECTS AND POLICY OF THE ACT. THIS STANDARD IS THE PRESENT LAW.

FOR MIXED SERVICE, S. 2170 WOULD ALSO REQUIRE (1) A FINDING THAT THE EXISTING SERVICE PROVIDED IN THE COASTWISE OR INTERCOASTAL TRADE BY ALL VESSELS IS INADEQUATE; AND (2) A CONDITION INSURING THAT THE GRANT WOULD NOT RESULT IN THE PROPOSED SERVICE BEING SUPPORTED, DIRECTLY OR INDIRECTLY, BY ODS. AS IS WELL KNOWN, THERE IS PENDING BEFORE THE AGENCY, A MIXED SERVICE APPLICATION BY AMERICAN PRESIDENT LINES, LTD. TO SERVE HAWAII WITH ITS CALIFORNIA AND/OR NORTHWEST CONTAINERSHIP SERVICES TO THE FAR EAST. SINCE THE INITIAL DECISION BY THE ADMINISTRATIVE LAW JUDGE IS UNDER REVIEW BY THE MARITIME ADMINISTRATION, IT IS INAPPROPRIATE TO DISCUSS THE MERITS OF THE PENDING PROCEEDING. HOWEVER, I WILL MENTION THAT THE RANGE OF LEGAL STANDARDS ARGUED BY THE LITIGANTS COVERS THE EXTENT TO WHICH, IF ANY, "INADEQUACY" IS INCLUDED, UNDER PRESENT LAW.

WITH RESPECT TO BARRING ODS SUPPORT FOR DOMESTIC OPERATION, THE ADMINISTRATION BELIEVES THIS REQUIREMENT IS ESSENTIALLY UNNECESSARY. SECTION 605(a) OF THE 1936 ACT NOW GENERALLY PROHIBITS THE PAYMENT OF ODS FOR OPERATION IN THE COASTWISE OR INTERCOASTAL TRADES, EXCEPT UNDER FOUR SPECIFIED CIRCUMSTANCES, EACH OF WHICH INCLUDES A FOREIGN VOYAGE AS WELL AS DOMESTIC TRADE. IN THESE FOUR CIRCUMSTANCES, THE SUBSIDY PAYMENTS FOR THE ENTIRE VOYAGE MUST BE REDUCED BY AN AMOUNT WHICH BEARS THE SAME RATIO TO THE SUBSIDY OTHERWISE PAYABLE AS THE GROSS REVENUE OF THE DOMESTIC SERVICE PORTION BEARS TO THE GROSS REVENUE DERIVED

FROM THE ENTIRE VOYAGE. THE ADMINISTRATION BELIEVES THE PROVISIONS IN CURRENT LAW ARE ADEQUATE TO PREVENT THE DIRECT OR INDIRECT PAYMENT OF ODS FOR DOMESTIC SERVICE.

FOR OTHER LINER SERVICES, S. 2170 WOULD FURTHER ADD THE REQUIREMENT THAT THE PROPOSED DOMESTIC SERVICE BY THE AFFILIATE OF THE SUBSIDY CONTRACTOR NOT BE PROVIDED WITH ANY CDS-BUILT VESSEL OVER 25 YEARS OLD. IN THE ADMINISTRATION'S VIEW, RESOLUTION OF SUCH CONCERNS SHOULD NOT BE SEPARATELY ADDRESSED IN LEGISLATION PERTAINING SOLELY TO SECTION 805(a), BUT IN THE OVERALL CONTEXT OF THE ENTIRE RANGE OF MARITIME POLICY DIRECTION, WHICH IS NOW UNDER REVIEW BY THE SECRETARY.

FINALLY, FOR BOTH MIXED SERVICE AND OTHER LINER SERVICES, THE SECRETARY WOULD BE REQUIRED TO INITIATE A HEARING TO DETERMINE WHETHER THE PRESENT MIXED OR AFFILIATED SERVICE BY A COMMON CARRIER COMPLIES WITH SECTION 805, AS AMENDED BY THIS BILL, AND THE SECRETARY MUST ISSUE AN ORDER PRESCRIBING CONDITIONS NECESSARY TO BRING ANY NON-COMPLYING OPERATOR INTO COMPLIANCE. THE ADMINISTRATION IS STRONGLY OPPOSED TO ANY RETROACTIVE APPLICATION OF NEW STANDARDS IN THIS BILL AND BELIEVES, IF LEGISLATION IS PURSUED, THAT EXISTING WAIVERS UNDER CURRENT LAW SHOULD CONTINUE TO BE HONORED FOR THEIR TERMS.

PROCEDURALLY, ALL THREE TYPES OF APPLICATIONS REQUIRE A TRIAL-TYPE HEARING, THOSE FOR BULK OPERATIONS AND OTHER LINER SERVICES WITHOUT ELABORATION, THOSE FOR MIXED SERVICE ON IDENTIFIED EVIDENCE. THE ADMINISTRATION VIEWS THIS PROPOSAL AS UNNECESSARILY REVERSING THE TREND TOWARD DEREGULATION. THE

DEPARTMENT'S NEW HEARING RULE (46 CFR PART 203) APPLIES TO HEARINGS MANDATED BY SECTION 805(a) OF THE 1936 ACT. THAT REGULATION PROVIDES FOR A PROCEDURE SHORT OF FULL-FLEDGED HEARINGS WHEN APPROPRIATE. THE ADMINISTRATION BELIEVES THAT THE APA-MANDATED HEARING REQUIREMENT IN S. 2170 WOULD RESULT IN NEEDLESS DELAY, AND EFFECTIVELY PRECLUDE FLEXIBLE ADMINISTRATION OF SECTION 805(a).

IN SHORT, THE ADMINISTRATION BELIEVES THAT THERE IS NO NEED FOR THIS LEGISLATION. THE PROCEDURAL IMPOSITIONS ARE UNNECESSARY GIVEN RECENT REGULATORY CHANGES AND WOULD RESULT IN REDUCED FLEXIBILITY IN ADMINISTRATION. IT IS IMPORTANT THAT THE AGENCY BE ABLE TO RESPOND TO THE CHANGING NEEDS OF THE INDUSTRY AND THE SHIPPING PUBLIC WHILE MAINTAINING PROCEDURAL SAFEGUARDS FOR ALL AFFECTED PARTIES. THE SUBSTANTIVE CHANGES INVOLVE AN UNJUSTIFIED DISTINCTION AMONG PROPOSED SERVICES AND HAVE NOT BEEN SHOWN TO BE NECESSARY GIVEN PRESENT LAW.

THIS CONCLUDES MY STATEMENT, MR. CHAIRMAN, AND I WILL BE PLEASED TO ANSWER ANY QUESTIONS THAT YOU OR OTHER MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

Senator **Breaux**. Thank you, Mr. Patton.

We have questions. I will recognize my colleague Senator Inouye first if he would like.

Senator **Inouye**. Yes. Do you believe that currently the Hawaii-mainland trade is adequately served?

Mr. **Patton**. The questions of whether it is adequately served and what adequacy constitutes are the key issues in the present proceeding in Docket S-801 before the agency, and they will have to be decided by the Deputy Maritime Administrator since they are definitely some of the issues that are pending.

Senator **Inouye**. As I understand it, according to APL's own expert witness at the MarAd hearing, the capacity in the Mainland-Hawaii trade—without APL—would exceed cargo by about 19,000 forty-foot equivalent unit containers. Is that correct?

Mr. **Patton**. I do not know.

Senator **Inouye**. Can you check on that, please?

[The following information was subsequently received for the record:]

The 19,000 and 50,000 FEU figures appear to have been taken from the Initial Decision of the Administrative Law Judge in Docket S–801 (pages 124 and 125), and are derived from estimates of capacity and demand for 1990 submitted by Matson and American President Lines during the proceedings of that docket.

Because a final decision by MarAd on the docket is pending, it would be inappropriate for us to comment at this time on the specific arguments of the parties, including material submitted in support of those arguments. These FEU figures were not developed by the Maritime Administration.

Senator **Inouye**. And secondly, if APL got into the trade that capacity would exceed cargo by nearly 50,000 FEU's. And now, with the announcement by Sea-Land of adding five more vessels, I would suppose that would significantly increase the 50,000 figure.

And would you say, those numbers are evidence that the trade is being adequately served?

Mr. **Patton**. Certainly if "adequacy" is defined as overtonnaging or capacity exceeding the cargo that is moving, certainly an excess of capacity in that definition would define "adequacy," more than adequacy.

Senator **Inouye**. Do you have any standards or guidelines by which you determine when a trade is overtonnaged?

Mr. **Patton**. Under 805(a) or 605(c)?

Senator **Inouye**. In section 805 proceedings.

Mr. **Patton**. What the appropriate standards and how they should be calculated at the present time in this proceeding are obviously in contention before they, and a fair divergence of views are being argued before us over that subject, what the appropriate standard should be will have to be decided.

Senator **Inouye**. Do you believe that the phrase "comfortable margin of supply over demand" would be equivalent to being overtonnaged?

Mr. **Patton**. Comfortable supply of——

Senator **Inouye**. "Comfortable margin of supply over demand." I use this phrase because I saw it in the APL statement, suggesting that the consequences of APL entering the mainland-Hawaii trade would bring about a "comfortable margin of supply over demand."

Mr. PATTON. To the extent "adequacy" was defined as the available capacity exceeding the cargo expected, that definition would seem to define "adequacy" in that context.

Senator INOUYE. Mr. Chairman, I have several other questions I would like to submit to MarAd. They are of a technical nature.

Senator BREAUX. Without objection, those questions will be made part of the record to go to MarAd for their response.

Senator INOUYE. I just want to ask one more.

Senator BREAUX. Certainly.

Senator INOUYE. Mr. Chairman, I have always looked upon this issue as an issue of fairness. We have had the Jones Act for 70 years. Relying upon that, domestic shipping companies have invested vast sums of moneys, not in just ship building but in facilities also. It doesn't seem fair to change the rules at this juncture—and relax the Jones Act protections indicrectly, by giving a subsidized company an edge. The ships the subsidized company will use to compete with are built with a subsidy.

Mr. PATTON. Senator, I believe there is a large debate over what the present rules are. Very able counsel have represented the parties in the proceedings before the Maritime Administration contending what the present rules are and should be.

So it is a little difficult to say at the present time what the result of the resolution of that dispute will be.

Senator INOUYE. What would happen if a decision is made and we permit subsidized lines to get into the trade and as a result the unsubsidized lines go bankrupt? Would they have any recourse?

Mr. PATTON. The question in terms of the permission themselves that were granted, involve what conditions to apply and whether they would continue. These are issues in connection with attaching appropriate conditions, if any, to approvals that are granted.

I do not begin to be able to know whether a bankrupt company would have a recourse against another company as a result of government action. That would be between the private parties.

Senator INOUYE. Thank you.

Senator BREAUX. Thank you, Senator.

Let me ask a couple questions for the record as much as anything else. Can you tell me how long the current laws regarding the prohibition of ODS operators getting into the domestic trade has been on the books?

Mr. PATTON. 1936.

Senator BREAUX. And over that period since 1936, approximately how many, a ballpark figure, applications has MarAd considered for entry into the domestic trades through the payback provision allowed under section 605?

Mr. PATTON. I wish I knew, Senator.

Senator BREAUX. Well, is it five, a hundred, or is it a thousand? A ballpark figure?

Mr. PATTON. It is probably over hundreds. We just do not have the historical records, unless we went back through the warehouses and pulled them out. My guess would be certainly in the hundreds.

Senator BREAUX. And essentially the intent of the Congress as I understand it since 1936 has been to allow ODS operators to come into a domestic trade if they paid back the ODS subsidy and they do not create unfair competition in that domestic trade; is that essentially correct?

Mr. PATTON. And their coming in is not prejudicial to the objects and policies of the Act, and they do not divert subsidy into that service.

Senator BREAUX. Now, in that consideration of those standards and applying it to determine whether an operator qualifies for the section 805 exemption, what types of things currently are considered to determine whether an unfair competition situation would be created?

In other words, give me the items that you would take a look at in any application, not any particular one but generically? What things does MarAd have to look at to determine whether that application meets the requirements of the existing section 805?

Mr. PATTON. Well, there certainly is some dispute over the weight to be given the different factors under the test of unfair competition. But I certainly think the major ones, would include the following: one, does use of the subsidy give rise to substantial competitive advantage over domestic operators; two, would the applicant compete fraudulently or engage in other illegal or unethical conduct; and three, similarly, would the applicant compete in any other way that is unfair under accepted legal or ethical principles?

Senator BREAUX. Are those standards that you just related to the committee, are those part of the statute or are those part of the regulations, are those part of general policy of MarAd? Or how is that reached?

Mr. PATTON. That has evolved from the administration of the provision and from court cases that have challenged or contested previous 805(a) approvals.

Senator BREAUX. So it is both by policy of MarAd and by court decisions that have been reached through challenges of litigants over the years?

Mr. PATTON. Correct. There is no regulation, nor does the statute spell out these factors.

Senator BREAUX. What is your response to someone who would allege that, well, the reason why legislation is needed now is because, look, we applied all the types of different standards at different points over the course of section 805 being written on the books; sometimes you use an adequacy test, sometimes you use an unfair competition test; nobody knows what the real standard is; therefore legislation such as this is essential to clear up once and for all what we are really trying to base an 805 application decision on?

Mr. PATTON. Congress is certainly free to change——

Senator BREAUX. Well, I know that. But I mean, suppose I say, look, you have been all over the ballpark with these interpretation. I know we are free to change it any time we want.

Mr. PATTON. Right.

Senator BREAUX. There is no question about that. That is a given.

What about the specific allegation that, look, you guys have been using all kinds of different standards every other month or every other application, and there is no consistency? Do you have a definitive answer or response to that?

Mr. **Patton**. Well, I think there has been some degree of consistency throughout the years. There is some debate over some of the margins. That should not necessarily overlook the fact that there has been some consistency, at least in terms of the overall factors that are looked at.

There is a great deal of debate over what is necessary to comply with those factors and some debate, over what the factors should be.

Senator **Breaux**. If the legislation were adopted, what would you perceive to be the burden of the applicant in proving inadequacy of current service?

Mr. **Patton**. It would depend in part on what Congress intended in the term "inadequacy." But whatever——

Senator **Breaux**. Just use the current dictionary definition of "inadequate" and try and apply it to an application.

Mr. **Patton**. Well, it has had two different kinds of contexts even in this discussion: one, degree of satisfaction by the shipper—are all ports served, is there adequate frequency of service—another, strictly overtonnaging for the entire trade.

Senator **Breaux**. What about pricing? Does that enter into that?

Mr. **Patton**. Pricing certainly could enter into the first factor in a qualitative sense of inadequacy, depending upon what Congress means in this bill. Obviously, depending upon what that intention is, it would play upon what burden of proof the applicant would have to meet.

Senator **Breaux**. My one final point is, what about the difficulty of isolating ODS subsidy payments to a company that would be operating with an 805 approval on any portion of their vessels?

Is it possible? Is it a problem? Is it very difficult or is it impossible to assure that ODS subsidies do not filter down to the non-ODS subsidized operations of a company which would be approved under an 805 application?

The complaint is: Look, I do not care what you tell them; they are going to have ODS subsidies on some of their ships, it is going to help them operate their non-subsidized vessels, and that isn't fair.

Mr. **Patton**. The solution in 1936 was section 605(a) in terms of mixed service. The attempt was to fix it to the revenue earned as the fairest means of addressing that problem.

Senator **Breaux**. Does it work?

Mr. **Patton**. There obviously is great debate in this case alone whether it works adequately, and certainly in the absence of I am not prepared to suggest, resolution of that issue whether it presently works adequately or, if it does not, what better might——

Senator **Breaux**. If you approve an 805 application, do you not in fact have to substantially show to your satisfaction, the government's satisfaction, that that situation has been adequately addressed, that the ODS subsidy does not filter through to non-ODS operations, before you can approve an 805 application?

Mr. **Patton**. That is correct.

Senator **Breaux**. Okay.

Senator Lott.

Senator **Lott**. Thank you, Mr. Chairman.

I will try not to repeat questions that you have been asking, although, since I missed some of them, it may be necessary.

First I want to say, Mr. Patton, I am sure you are the one that——

Mr. PATTON. No sorrier than I am, sir.

Senator LOTT [continuing]. Has the opportunity to be here today. I do not think ordinarily you would—you already said that? Okay, you said that.

But somebody has to answer some of these questions that we have in mind, so you are it.

Now let me start off by asking, what about the applicability of this particular legislation? I presume that you at least were able to do that, review the bill, and can give us some idea of what its reach might be. The general perception is, at least mine was earlier on, that it was particularly relevant to the Hawaii situation, but I understand it may have a much broader reach than that.

Can you give me some idea of other types of situations, other areas, that it might be applicable to?

Mr. PATTON. Yes, Senator. There are very few pending 805(a) permissions that are granted in terms of the impact of a retroactive application. APL has a limited 805 approval. Waterman has an affiliation-type of approval. Lykes has an approval that it does not now use with respect to Puerto Rico. The U.S. Lines contract, U.S. Lines S.A., had various approvals in it.

To my knowledge, those are the only current pending permissions that would be affected. In terms of the future, certainly depending upon how ODS reform went or how the carriers initiated new services, Puerto Rico would be one offshore trade that might be affected if subsidized service were started there.

Senator LOTT. Senator Breaux was asking you questions about what are the factors that are considered in determining whether or not a subsidized shipper should be permitted to get into these routes. But let me get you to, if you would, list them again, what the key factors are.

Mr. PATTON. I prefaced my response by saying that to some extent the factors are in dispute before the agency with respect to this proceeding and therefore with trepidation I listed some of those that seem to be agreed, without stating that there might well be others that the parties believe—and I do not mean, by my omission to indicate that they are not part of the record—will be considered.

But the three I listed were: does use of the subsidy give rise to substantial competitive advantage over domestic operators; would the applicant compete fraudulently or otherwise illegally or unethically; and would, similarly, the applicant compete in any other way that is unfair under normally accepted concepts of legal or ethical principles.

Senator LOTT. And if the answer to either one of those is yes, then it would not go forward, is that correct?

Mr. PATTON. I believe that is correct.

Senator LOTT. And there is this process that is set up that you apply and you go through, and it has generally speaking apparently worked well over many years. But there are those that maintain that the existing law, the 1936 law I guess it is, is being eroded.

Is that your impression? Do you think that is the case?

Mr. PATTON. That has been, in so many words, stated here, yes, sir.

Senator LOTT. It has been what?

Mr. PATTON. In so many words stated here, the concern is that section 805(a) has been eroded.

Senator LOTT. Did you say that?

Mr. PATTON. I did not say that. I am just acknowledging that has been stated.

Senator LOTT. Well, as the Deputy Chief Counsel to the Maritime Administration, what is your opinion on that?

Mr. PATTON. Well, it very much involves what the current law is, and the current law is very much in debate in terms of the standards and relevance and how it should be applied in this APL case.

I do not think I can safely state my personal opinion on the subject, and I think the agency is going to have to resolve the dispute that is before it; the issues and they are ably submitted by counsel on all sides to provide resolution of what the current law is.

Senator LOTT. Has the agency stated a specific position on this piece of legislation?

Mr. PATTON. I had a statement, yes, sir.

Senator LOTT. And it is?

Mr. PATTON. It is basically that we felt that it was unnecessary, that there should not be three separate standards for three different types of services.

Senator LOTT. Mr. Chairman, I think I will reserve the rest of my time and questions for our panelists we have.

Senator BREAUX. Senator Inouye, do you have any other follow-up questions?

[No response.]

Senator BREAUX. Let me just ask one other question. Some will testify that the legislation really reaffirms or restates the intent of Congress when the original bill in 1936 was adopted. Is it your interpretation that it represents a restatement of the existing policy or that it is a more difficult standard to meet in approving an 805 application than under the current law as it is being applied?

Mr. PATTON. The difficulty I have in responding is that one of the key issues pending in the proceeding is the extent to which, under current law, inadequacy must be the critical factor in making a determination. If that view were accepted, then the difference between the present bill for mixed service and the present law as so interpreted would be perhaps very little.

If that view were not accepted, then obviously in a mixed service area a bill that had as the only criteria the up-or-down criteria of inadequacy would be different from the other asserted position that that is just one criteria.

Senator BREAUX. What is your opinion on that?

Mr. PATTON. I am afraid we have very able briefs before the Maritime Administration, and we are going to have to make a decision on that.

Senator BREAUX. You have no opinion as to whether the current proposed legislation would impose new standards for deciding an 805 application?

Mr. Patton. If the agency concludes that inadequacy is a critical factor that must be decided before approving this application, then on the mixed service area there might be very little difference between this bill and the present law. If the agency decides that it is not and it is just one, then this bill would significantly increase the difficulty of getting section 805 permission in mixed service cases.

Senator Breaux. What has the agency been doing since 1936? I mean, these decisions have been before the agency and applications have been regularly decided. Based on the history of the Maritime Administration in looking at 805 applications is adequacy part of the mix in determining whether unfair competition would result or is it not?

Mr. Patton. It frequently has been part of the mix. Part of the question is what is inadequacy and how critical it is, and there have been cases. But right now that is one of the contested issues that this case is going to decide.

Senator Breaux. What case?

Mr. Patton. The application of American President Lines.

Senator Breaux. Well, I am not talking about a pending case. I am talking about you have been doing this since 1936.

Mr. Patton. Right.

Senator Breaux. The question is, does this bill change the standards that you have been applying since 1936 or not? It seems like a relatively straightforward question.

Mr. Patton. It is a relatively straightforward question.

Senator Breaux. A relatively straightforward answer is what I am looking for.

Mr. Patton. The problem is the litigants are framing what the history has been——

Senator Breaux. I am not talking about litigants if you are talking about a particular case. I am talking about generically since 1936 you have had hundreds of cases that have come before the Maritime Administration asking for a waiver. Over the history of those applications which have now been decided, is adequacy part of the consideration or has it not been?

Mr. Patton. It has been a part.

Senator Breaux. It is part of it.

Mr. Patton. The question is whether it must be a critical part.

Senator Breaux. The legislation would make it a critical part?

Mr. Patton. Yes.

Senator Breaux. You think that is not necessary?

Mr. Patton. The question in part before us is whether under the present law it is a critical factor. That is what is argued before the agency presently.

Senator Breaux. Let me ask you, do you oppose or support the legislation?

Mr. Patton. We oppose the legislation.

Senator Breaux. Okay. Thank you very much for your testimony. We appreciate it.

Let us welcome up the next group of witnesses. Panel number one would be: Mr. Bradley Mulholland, President and Chief Operating Officer of Matson; Mr. Stanley Barer, Chairman of the Board of TOTEM Resources Corporation. Gentlemen, we welcome you and look forward to your presentations. [Pause.]

Okay, gentlemen, we welcome all of you here with your counsels. Bradley, if you want to go ahead and start. We have you listed first. We would be pleased to receive your testimony.

STATEMENT OF C. BRADLEY MULHOLLAND, PRESIDENT AND CHIEF OPERATING OFFICER, MATSON NAVIGATION CO., INC.; ACCOMPANIED BY R.J. PFEIFFER, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER; AND MICHAEL B. ESCH, COUNSEL

Mr. **MULHOLLAND**. Mr. Chairman, members of the subcommittee: I am C. Bradley Mulholland, President and Chief Operating Officer of Matson Navigation Company. With me today is R.J. Pfeiffer, Chairman and Chief Executive Officer of Matson, and Michael Esch of the law firm of Patton, Boggs and Blow.

Matson appreciates the opportunity to appear——

Senator **BREAUX**. Let me just interrupt you. Sorry. But I am going to ask all of our witnesses to summarize their testimony if they can. We have, of course, your complete testimony of all of the witnesses, this panel as well as the next one.

Thank you.

Mr. **MULHOLLAND**. I have got less than four minutes worth of testimony in summary. Can I just go through it that way?

Senator **BREAUX**. Sure.

Mr. **MULHOLLAND**. S. 2170 is timely and urgently needed legislation to reaffirm the essential goals of the 1936 Act, the promotion and development of the domestic commerce and foreign commerce merchant marine.

America's domestic offshore community require a high level of service from the dedicated domestic commerce fleet. As part of that fleet, Matson carries needed goods for Hawaii's residents and brings Hawaii's goods to U.S. markets. To do so, Matson has invested over $500 million in capital assets for its Hawaii service in the last decade, including over $320 million for U.S.-built ships and barges.

Hawaii receives a high level of service from Matson and other unsubsidized U.S.-flag operators. Indeed, I just learned from a press release this morning that another unsubsidized carrier, Sea-Land, has acquired additional vessels and will double their annual calls at Hawaii.

However, the continued investment necessary to support dedicated domestic service cannot be made if unsubsidized carriers are faced with subsidized competition from U.S. international carriers. When it established the current subsidy program, Congress intended that unsubsidized domestic carriers be granted protection from unjustified incursions in domestic commerce by subsidized foreign commerce carriers.

Current Maritime Administration interpretation of section 805(a), however, ignores the Congressional policy which has sought to maintain our domestic commerce fleet by permitting subsidized foreign commerce carriers to serve domestic trades only if existing service in those trades is inadequate.

A recent decision by an administrative law judge would allow American President Lines to carry westbound cargo between U.S.

Pacific coast ports and Hawaii as part of its subsidized service between the U.S. and the Far East, even though the judge found that existing service to Hawaii would be adequate at least until 1995 without APL in the trade.

APL proposes to dedicate more than half of its subsidized vessels' cargo space to domestic Hawaii cargo, capacity equivalent to 25 percent of existing westbound cargo. This means that insertion of APL's capacity into an adequately served trade will lead to overcapacity in that trade, with resulting rate instability and reduce APL's capacity to serve America's foreign commerce.

In APL's own analysis, it would capture 25 percent of the available cargo, meaning that it would fill up all of its slots allocated to the Hawaii trade, which would cause Matson to lap up a vessel and delay construction of new vessels for the trade.

S. 2170 would reaffirm Congress' intent to protect unsubsidized domestic operators by conditioning permission for a mixed service application under 805(a) upon an express finding that existing service is inadequate, determined in terms of both quality and quantity of service. A subsidized vessel could serve a domestic trade where needed to fulfil the goal of having a merchant marine sufficient to carry all of our domestic commerce.

At the same time, where existing domestic service is adequate, the subsidized vessel would continue serving solely America's foreign commerce, for which it is paid subsidy and where it can help fulfil the statutory goal of having a merchant marine sufficient to carry a substantial portion of our foreign commerce.

The high quality of service provided to domestic offshore communities by unsubsidized operators will be jeopardized by the unrestricted incursion of subsidized carriers. Domestic operators are not asking for subsidy. All we want is the chance to compete on equal terms.

By reaffirming the Congressional intent that subsidized carriers be permitted to compete in the domestic offshore trades only in exceptional and limited circumstances, S. 2170 safeguards that equality of competition. There is an immediate and urgent need for 2170 and Matson urges its enactment now.

Let me make three brief points about the testimony you will hear later today. Rather than changing the rules in the middle of the game, as charged by Mr. Verdon of the USA group, S. 2170 reaffirms the rules laid down by Congress when it established the subsidy program. Subsidized carriers are paid ODS amounting to over $8 billion since 1936 to serve America's foreign trade. Congress intended that they be allowed to compete against unsubsidized domestic carriers when service provided by the domestic carrier is inadequate.

S. 2170 simply reaffirms the intent of Congress.

In all of his complaints of how unfair S. 2170 is, Mr. Verdon neglects to mention that under the USA legislative proposal APL would be automatically granted permission to serve Hawaii, regardless of any action on the merits of its application by either MarAd or the Federal courts. This overriding of established administrative and judicial safeguards is the essence of unfairness.

If the purpose of ODS reform is to improve the competitiveness of U.S. carriers in international trade, then domestic carriers have no problem with that goal. S. 2170 deals with an entirely separate issue, namely the unjustified incursion of subsidized U.S. carriers into the domestic trade.

As Mr. Rhein stated several months ago in his capacity as President of APL, the real competition for U.S.-flag carriers is not each other, but foreign carriers. I heartily agree, and that is why I believe that S. 2170 will benefit both the domestic and the foreign commerce U.S.-flag fleet and why it should be enacted now.

Thank you. I would be happy to answer any questions from the subcommittee.

[The statement and questions and answers follow:]

STATEMENT OF C. BRADLEY MULHOLLAND, PRESIDENT, MATSON NAVIGATION CO., INC.

Mr. Chairman and Members of the Subcommittee,

I am C. Bradley Mulholland, President and Chief Operating Officer of Matson Navigation Company, Inc. ("Matson"). I appreciate this opportunity to present Matson's views on S. 2170, a bill that would amend Section 805(a) of the Merchant Marine Act, 1936, to reaffirm the conditions under which subsidized vessel operators may engage in the coastwise and intercoastal trades.

We support this bill as timely and urgently needed legislation to maintain the essential goals of the 1936 Act -- the promotion and development of our merchant marine, including our domestic trade fleet as well as our foreign trade fleet. Both fleets are vital to our nation's commerce and national security; while government promotion of the U.S.-flag foreign trade fleet remains an important, though sometimes difficult objective, we believe that its promotion must not come at the expense of the domestic trade fleet.

Matson is proud of its long history as a carrier in the domestic shipping trades. We have provided service to Hawaii without interruption since 1882, including service during World Wars I and II as agent of the U.S. Government. Today, Matson operates an efficient fleet of container and roll-on/roll-off vessels carrying primarily containerized cargo and automobiles between U.S. west coast ports on the mainland and the port of Honolulu on the island of Oahu. Cargo destined for the Neighbor Islands of Hawaii, Kauai, and Maui is transshipped in Honolulu from Matson's line-haul vessels to its container barges for delivery to four Neighbor Island ports. On the return trip from Honolulu to the U.S. west coast, Matson's fleet carries Hawaii's agricultural products as well as automobiles, household goods, and other cargo. The volume of inbound cargo from Hawaii to the mainland is only a third, however, of the volume of outbound cargo going from the mainland to Hawaii, and it is the outbound segment that is the heart of the Hawaii trade. As an exclusively domestic operation, Matson's Hawaii service receives no government subsidy for vessel construction or operation.

Matson strives to provide a high level of service to its customers, commensurate with their needs and the needs of the state of Hawaii as a whole. To maintain its high level of service, Matson has regularly invested millions of dollars in equipment for the U.S. west coast/Hawaii trade, amounting to some $500 million since 1980, including over $320 million for U.S.-built vessels and barges. Recently, Matson signed a contract for the construction of a new, $129 million containership at National Steel and Shipbuilding Company in San Diego. This vessel is the first new commercial vessel to be built in a U.S. shipyard since 1987.

The Domestic Offshore Trades

The domestic offshore commerce segment of the U.S. Merchant Marine serves the domestic trades between the continental United States and domestic communities such as Hawaii, Alaska, and Puerto Rico. Domestic offshore commerce carriers have a substantial impact on the employment of thousands of maritime and longshore workers throughout the United States.

The services provided by domestic offshore commerce carriers are essential to the economies of the states of Hawaii and Alaska, and the Commonwealth of Puerto Rico. Hawaii and Puerto Rico are island economies which are dependent on regularly-scheduled, U.S.-flag ocean common carrier service to provide the "pipeline" through which needed goods are delivered, and through which the products of these islands can reach mainland markets. Although Alaska is part of the mainland, its distant location means that its economy is similarly dependent on American ocean common carriers.

The domestic offshore communities must be assured of a U.S.-flag domestic commerce fleet which is dedicated to serving them, regardless of the changing economics of international shipping operations. There can be no assurance that domestic carriers will be able to make investments, such as the one-half billion dollars that Matson has invested in its Hawaii service over the past decade, if they are faced with subsidized competition from U.S. international carriers, who are free to serve the domestic trades at their convenience.

The Need for S. 2170

S. 2170 would reaffirm the original Congressional intent that Section 805(a) should provide substantial protection for unsubsidized domestic operators against incursion into the domestic trades by subsidized foreign trade carriers. The goals of both the 1920 and the 1936 Merchant Marine Acts are to promote the development of strong domestic and foreign trade fleets, as a means of fostering our nation's commerce in time of peace and our national preparedness for times of war or national emergency. By reserving transportation of our water-borne domestic commerce to U.S.-flag companies operating U.S.-built vessels, the Jones Act ensures the maintenance of our domestic trade fleet.

In the foreign trades, such reservation of cargo is not feasible. In the 1936 Act, Congress established a subsidy system to enhance the competitiveness of U.S.-flag operators against generally lower-cost foreign-flag companies. The Act authorizes subsidy for both vessel construction and vessel operation, and generally provides that such subsidies are to be calculated by the differential between the costs of U.S.-built, U.S.-flag vessels and the costs of competing foreign-built, foreign-flag vessels.

When this subsidy system was proposed, it was universally recognized that it would be fundamentally unfair, as well as a waste of government money, for the carriers subsidized for foreign trade operations to engage in the protected domestic trades. Therefore,.subsidized vessels are in principle committed exclusively to foreign trade operations.

In order to preserve a very limited amount of flexibility, however, Congress provided for four exceptions for subsidized operators to engage in domestic trading incidental to foreign trade voyages. The four exceptions are narrowly defined in geographic terms: round-the-world voyages; voyages from the U.S. east coast to the Far East; voyages from the U.S. west coast to Europe; and foreign trade voyages on which the subsidized vessel may stop at the State of Hawaii or an island possession or territory of the United States under very limited conditions.

The legislative history indicates that these exceptions were adopted in view of then existing service routes and the belief that, in some situations, service to an offshore domestic port might be economically feasible only when made in conjunction with a foreign trade service.

Even within these narrowly drawn geographic exceptions, two further and significant limitations apply. First, if any domestic trading is undertaken in the course of a foreign trade voyage, the operating subsidy payable for the voyage is to be reduced, with the reduction roughly measured by the ratio of domestic revenues to total revenues earned on the voyage. Second, before any such domestic trading can be commenced the subsidized operator must receive written permission under Section 805(a) from the Secretary of Transportation. The standards for granting such permission are the focus of S. 2170.

Written permission under Section 805(a) was not intended to be lightly regarded or routinely granted. Section 805(a) specifically confers both a right to a hearing and a right of intervention upon any party interested in the application. Before permission may be granted, the Secretary must make two independent findings: first, that the proposed service will not result in "unfair competition" to any person operating an exclusively domestic service; and second, that the proposed service will not otherwise be "prejudicial to the objects and policy of the Act." The content of these findings is indicated by the grandfather clause, which granted permission for the then-existing (1935) domestic operations of subsidy applicants "without requiring further proof that public interest and convenience will be served by such operation." By exempting operators with grandfather rights from making such a showing, Congress plainly indicated the type of showing all other applicants must make.

The Section 805(a) requirement applies not just to incidental domestic trading by the subsidized vessel itself, known as a "mixed" domestic and foreign service, but extends to any vessel operations by an affiliate of a subsidy contractor, or "any officer, director, agent, or executive thereof." Domestic operation of an unsubsidized vessel subject to Section 805(a) by reason of related ownership or other affiliation to a subsidized operator is often referred to as an "affiliated" service. Both mixed and affiliated services require Section 805(a) approval, but the very different circumstances of the two types of applications naturally give rise to differing treatment. In particular, a mixed service application for operation of a subsidized vessel directly in the domestic trade raises concerns of a greater magnitude, given the inherent possibility of subsidy spillover and the diversion of U.S.-flag capacity from the foreign to the domestic trade.

Application of the Section 805(a) Standards

The "objects and policy of the Act" are set forth in the statutory purposes listed in Section 101 of the Act. Principal among these are promotion and development of a U.S.-flag Merchant Marine sufficient to carry (1) all of our domestic water-borne commerce and (2) a "substantial portion" of our water-borne export and import commerce. As noted, the maintenance of a domestic trade fleet is provided by our cabotage law, the Jones Act, and the promotion of a foreign trade fleet is the object of the subsidy system, cargo preference laws, and other measures.

For many years, these statutory goals have been applied in the context of Section 805(a) proceedings through an examination of the adequacy of the existing service in the domestic trade at issue. The determination of adequacy has been a key criterion in the maritime agency's determination whether to grant permission under Section 805(a) for a mixed service application.

From the earliest days of the Act until the early 1960s, the maritime agency responsible for administering the Act developed and applied a doctrine known as "fundamental entitlement". Under that doctrine, domestic operators were essentially given a right of first refusal to domestic cargo for which they had the need and capacity to carry. If "grandfather rights" did not apply, that doctrine required the rejection of almost any opposed Section 805(a) application, whether the application involved a single shipment or a regular service, and without requiring an analysis of the adequacy of the quality or quantity of the existing service.

The doctrine of fundamental entitlement was overturned by the courts in the case of Pacific Far East Line, Inc. v. Federal Maritime Board, 275 F.2d 184 (D.C. Cir.), cert. denied, 363 U.S. 827 (1960), insofar as it was applied to deny, under the "unfair competition" standard, an application for an affiliated service by an unsubsidized vessel. While perhaps not compelled to do so by the terms of that decision, the agency thereafter abandoned application of the extreme doctrine of fundamental entitlement. In its stead, it recognized adequacy of service as a critical factor in Section 805(a) applications.

In States Steamship Co. - Calls at Hawaii, 5 SRR 1111 (Sec. Commerce 1965), the agency found that granting the application for additional service would alleviate certain inadequacies in the existing service, including providing needed service to the port of San Diego. By contrast, the doctrine of fundamental entitlement would have required denial of the application, by reserving to the existing carriers all the cargo they could possibly carry, including by service from other ports.

The Secretary emphasized:

> [A]pproval of this application does not mean it is felt desirable to encourage subsidized operators to build up ocean transportation service in our domestic trades. Ideally, we could wish for adequate service in those trades entirely by unsubsidized operators.

Id. at 1147 (emphasis added).

In the leading case of Matson Navigation Company v. Connor, 258 F. Supp. 144 (N.D. Cal. 1966), aff'd, 394 F.2d 514 (9th Cir.), cert. denied, 393 U.S. 998 (1968), the court upheld the States Steamship decision. While approving the grant of the application on the facts of that case, the court held that unsubsidized domestic operators

> will still receive substantial protection from Section 805(a). Permission to enter the domestic trade by a mixed service operator will only be granted as a final resort when adequate service by an unsubsidized operator is unavailable.

Id. at 158 (emphasis added). The court's holding reflects both the express statutory goal of promoting the maintenance of the unsubsidized domestic fleet and the decision of the Secretary below.

No mixed service application has been granted where the quality and frequency of service by existing domestic operators has been found to be adequate. However, recent opinions by the maritime agency indicate a deviation from the original statutory scheme set up by Congress that requires a reaffirmation of the Congressional standards.

Reaffirmation of Congressional Intent Required to Correct Agency Misinterpretation

Perhaps frustrated by its inability to have subsidy reform legislation enacted in recent years, the Maritime Administration has taken steps to aid the subsidized foreign trade fleet by administratively easing restrictions on the scope of their operations, including easing access to the protected domestic trades under Section 805(a).

In particular, in a December 1984 opinion in an affiliation case, Aeron Marine Shipping Co., MarAd Docket S-724, the Secretary of Transportation mistakenly equated consideration of adequacy of existing service with the doctrine of fundamental entitlement. Indeed, the Secretary held that to defeat an application, unsubsidized carriers must prove that the applicant's proposed service will not only drive existing carriers out of the trade, but must further demonstrate that this will result in long term insufficient capacity in the trade. The Aeron decision improperly distinguished between providing substantial protection to existing domestic operators and protecting the interests of shippers; the shippers' interests, as embodied in the goals of the statute, are to promote the development and maintenance of a healthy merchant marine, adequate to carry all domestic water-borne cargo. The decision was challenged in the courts, but while the case was pending on appeal, the application was withdrawn and the case rendered moot.

The Secretary's decision nevertheless continues to cause mischief, resulting in confusion within the agency, and an incorrect application of Aeron beyond even its limited holding.

This ongoing problem is exemplified by the Initial Decision by an administrative law judge in MarAd Docket S-801, the application of American President Lines to enter the West Coast-Hawaii trade. That decision, erroneously applying Aeron as the governing standard, recommends granting Section 805(a) permission to a subsidized operator to carry domestic cargoes to Hawaii as part of a weekly subsidized service to the Far East. The applicant, APL, proposes to dedicate more than half of its vessels' capacity to domestic Hawaii cargo, equivalent to 25% of the existing outbound cargo offered. The ALJ found on the record that existing service to Hawaii would be adequate, not only in 1990, the projected first year of domestic operation, but at least until 1995. Despite that finding, the ALJ recommended granting the requested permission, initially for a five-year period, with an opportunity for extension of the permission after a further review. The decision acknowledged that APL would not be contributing to expansion of the merchant marine, as it might if it were to introduce new ships in a dedicated, unsubsidized domestic service; but instead would, on a short-term basis, divert existing cargo capacity away from the foreign trades. In APL's own analysis, it would capture 25% of the available cargo (that is, fill up all its slots dedicated to the Hawaii trade), cause Matson to lay up a vessel, and delay construction of new vessels for the trade.

If upheld by the agency, this misapplication of Section 805(a) would have a doubly devastating impact on the statutory goals. Not only would it reduce the domestic trade fleet, but it would also reduce U.S.-flag capability in the foreign trades. The undisputed evidence shows that the diversion of capacity would substantially detract from the acknowledged goal of 50% U.S.-flag carriage of our foreign trade, dropping U.S.-flag capability in the trade by five percentage points, from 34% to 29%.

Reaffirmation of the substantial protection of unsubsidized domestic carriers intended by Congress is required to prevent misinterpretation of the Act and deviation from the long-standing Congressional goals. S. 2170 would do that by conditioning permission for a mixed service application under Section 805(a) upon an express finding that existing service is inadequate. Adequacy of existing service can be determined, as it has been addressed consistently in past cases, in terms of both quantity and quality of service. This standard provides the measure of flexibility intended by the 1936 Act to allow a subsidized vessel to engage in the domestic trades where needed to fulfill the statutory goal of developing a merchant marine sufficient to carry all our domestic commerce. At the same time, where existing domestic service is adequate, it allows the subsidized vessel to continue operating in the foreign trade, for which it is paid subsidy, and contributing to the statutory goal of carrying a substantial portion of our foreign commerce.

The Legislation Is Timely

Where the administering agency has deviated from the statutory standards adopted by Congress, Congress obviously has the authority, indeed the responsibility, to reaffirm those standards in order to put the agency back on course. Action is required now, in order to prevent current and future applicants from taking advantage of the agency's deviation from the statutory goals.

As far as Matson is aware, the only current or proposed mixed use of a subsidized vessel in the domestic trades is the pending APL application to carry domestic cargo to Hawaii on its weekly subsidized service to the Far East. As provided in section 5 of the bill, S. 2170 would apply to APL's application to require that any permission granted on the application would be terminated if found not to conform with the restated requirements of Section 805(a).

Because S. 2170 only confirms Congressional intent in the application of the 1936 Act, I believe it properly applies to any outstanding permissions for domestic operation. This is not a situation where an applicant can contend that the standards have been changed after the fact. Indeed, the issue of adequacy of existing service has been an issue in every contested Section 805(a) application. With regard to Docket S-801, adequacy of service was extensively addressed both by the parties and by the ALJ in his Initial Decision. S. 2170 would simply confirm the proper interpretation of the existing statutory standards, which have been before the agency (and the applicant) from the start. APL can claim no "reliance" interest in the agency's past interpretation of the statute, because in no case has the agency granted Section 805(a) permission to a mixed service operator where the existing service was held adequate.

It may also be noted that the timing of APL's application to serve Hawaii demonstrates that its proposed entry into the domestic trades was not a predicate for its earlier decisions to enhance its foreign trade fleet. Rather, the application indicates that it was made at the spur of the moment, at a time when an existing Hawaii carrier, U.S. Lines, was in extreme financial trouble, indeed, had filed for bankruptcy, and Sea-Land Service, U.S. Lines' successor, had not yet entered the trade. At the time APL filed its two page letter of application in February 1987, it had not conducted any recent study of the feasibility of initiating a service to Hawaii. Its own internal documents showed that its most recent feasibility study had been conducted in 1984, and that study concluded that the Hawaii trade was relatively small and slow-growing and not an attractive market.

Opponents of S. 2170 might also take the opposite tack, claiming that, rather than coming too late, the legislation is too early. Because the APL application is still pending, Matson's immediate concerns with the direction of the agency's Initial Decision could be alleviated if the Maritime Administration denies the application on other grounds. Nevertheless, the Secretary of Transportation's Aeron decision presents a recurring problem of agency confusion and a continuing need for Congressional reaffirmation of the applicable standards under Section 805(a). The pending APL application makes the problem immediate; the continuing problem of the Aeron decision requires permanent legislative correction.

For its part, Matson is committed to continue providing a high level of service to Hawaii. Matson, together with the other operators in the trade, Sea-Land Service, Sause Brothers, and Aloha Cargo Transport, have and will provide a more than adequate service. The Hawaii trade is open to entry by any unsubsidized operator and various carriers have come and gone over the years. The trade is highly competitive, particularly for the core business of standard, dry cargo containers. Shippers' interests in competitive freight rates are overseen by the Federal Maritime Commission, which uses its authority to limit Matson's overall rate of return and to investigate and disapprove proposed rate increases.

S. 2170 Should Be Considered Separately from ODS Reform

For many years, the maritime industry, the administration, and Congress have debated a general reform of the operating-differential subsidy ("ODS") system. Those discussions apparently will continue for some time, as no consensus is immediately apparent. Although occasioned by the subsidy system, S. 2170 deals with a distinct and severable aspect of the system, concerning the exceptional and limited conditions under which ODS vessels may be allowed to enter the domestic trades. This issue can, and should, be kept separate from ODS reform in general. There is an immediate need for S. 2170, and it should be enacted now.

Thank you.

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C. BRADLEY MULHOLLAND
President
and
Chief Operating Officer
(415) 957-4565

June 20, 1990

The Honorable John B. Breaux
Chairman
Subcommittee on Merchant Marine
SH 425
Hart Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

In connection with my testimony on S. 2170 before the Subcommittee on May 16, 1990, I was asked to respond to a number of written questions forwarded to me by the committee staff. I am pleased to enclose my responses to each of those questions.

In addition, I received a separate set of questions directly from Senator Inouye's staff. For your information, I have also enclosed a copy of my cover letter and response to Senator Inouye, for inclusion in the hearing record.

Should the committee require any further information, please let us know, and we would be happy to provide it.

Sincerely,

CBMulholland

C. Bradley Mulholland

A&B A subsidiary of
Alexander & Baldwin, Inc.

COMMITTED TO SERVING HAWAII BEST

RESPONSE OF MATSON NAVIGATION COMPANY, INC. TO SUPPLEMENTAL WRITTEN QUESTIONS FROM THE MERCHANT MARINE SUBCOMMITTEE STAFF FOR THE HEARING ON S. 2170

1. Question:

As I understand it, without APL being in the Mainland-Hawaii trade, in 1990 capacity will exceed cargo by about 19,000 FEU containers.

With APL in, it is estimated that capacity would exceed cargo by nearly 50,000 FEU's.

Wouldn't the addition of 5 more vessels by Sea-Land (as I understand the number of vessels to be added) significantly increase that 50,000 figure?

Response:

Assuming that the Sea-Land vessels would be bringing in the same capacity that APL is proposing, it would increase excess capacity by at least another 30,000 FEU's, a significant increase.

2. Question:

USA and its member operators have been working among themselves on ODS reform proposals for several years. Several USA proposals have evolved over that time. One was dated last October, and a subsequent one was dated November, 1989. I believe there were earlier ones. In any event, the October, 1989 and November, 1989 proposals amended Section 805, and all of the USA members agreed among themselves on that provision.

(a) While the USA members consulted one another prior to reaching agreement on Section 805 in the October and November drafts, did USA consult with MATSON simultaneously or at any time before its members agreed among themselves on those drafts?

(b) Did USA represent that its position had not been "set in concrete" at the time it talked to MATSON?

Response:

By the time USA contacted Matson for the purpose of discussing Section 805(a) in the context of its ODS reform proposal, USA as a group had already decided on its position: that Sea-Land and APL, two subsidized carriers under ODS reform, would be granted permission to operate in the Mainland-Hawaii trade without regard to whether that would result in unfair competition or otherwise prejudice the objects and policy of the Act. From the outset of the discussions with Matson, there was no give in the USA position.

3. Question:

Under S. 2170, all applications of common carriers for Sec. 805 permission would be required to "disclose the nature and scope of operations proposed to be conducted in coastwise or intercoastal trade."

In Aeron Marine, I believe the Secretary of DOT held that an applicant need not specify its proposed operations.

Would you please give the Subcommittee your views on the "pros" and "cons" of the provision in S. 2170?

Response

The disclosure requirement is largely an issue of timing, i.e., whether the applicant must disclose its planned operations in its application, or through discovery responses after a proceeding is underway. Early disclosure benefits all parties, as it defines the relevant trades and the scope of proposed operations. In the past, domestic operators have been required, to protect their interests, to intervene unnecessarily in many Section 805(a) proceedings, simply because the applications failed to specify the limited permission actually sought.

Indeed, MarAd has recently amended its regulations to require all Section 805(a) applicants to "describe clearly the scope of permission sought, including details of proposed domestic service." 55 Fed. Reg. 12353, 12359 (April 3, 1990) (to be codified at 46 C.F.R. § 203.2). S. 2170 would reinforce that disclosure requirement.

4. Question:

One of the objects of the Merchant Marine Act is the promotion of our shipyards. CDS was effectively terminated in 1980, and commercial shipbuilding is all but nonexistent in the U.S. In fact, Congress at the behest of the ODS operators enacted temporary legislation on two occasions permitting those operators to build foreign. Now the ODS operators want that authority permanently.

(a) Operators who must build in the U.S. without exception are domestic operators, including Matson. If, as a consequence of a mixed service operator's entry into a domestic trade which is adequately served, a domestic operator's plans for new construction are curtailed, aren't the objects and policy of the Act being prejudiced?

Response:

As noted, the declaration of maritime policy set forth in Section 101 of the Merchant Marine Act states that it is necessary for the national defense and development of the United States foreign and domestic commerce that we have a merchant marine supplemented by efficient facilities for shipbuilding.

This policy is a consideration in Section 805(a) decisions. In the Grace Line case (1963), the Federal Maritime Board denied a Section 805(a) application for a mixed service operation as prejudicial to the objects and policy of the Act. The Board said:

> It should also be borne in mind that Grace would not be investing new capital in this trade, as the present domestic operators are doing, but would be using existing space . . . [on] its subsidized foreign service.

The goals of the Act are thus severely prejudiced by the negative impact on the commercial shipbuilding opportunities for our domestic shipyards. Matson has committed hundreds of millions of dollars in domestic building and reconstruction of vessels, but it cannot continue to do so without reassurance that the essential safeguards contained in Section 805(a) will remain intact.

5. Question:

Would you tell the Committee how much you have spent on new ship construction and expansion over the past five years, and what your plans for expansion are.

Response:

In five years through 1990 Matson has committed over $346 million for the purchase of vessels and vessel reconstruction, including a $129 million contract for a new containership, the first new commercial vessel to be built in a U.S. shipyard since 1987.

6. Question:

The reason why liner operators receive ODS is to put them on an operating parity with their foreign-flag competitors in our international trade. In fact, the Act provides that ODS will not be paid for additional U.S.-flag service in a trade, unless the existing U.S.-flag service is inadequate.

Section 805 permission, on the other hand, is concerned with our domestic trades, and the effect of competition in them between subsidized and unsubsidized U.S.-flag carriers.

Why therefore should a Section 805 issue be considered part of ODS reform, which is intended to put U.S.-flags on operating parity with their competitors in our foreign trades?

Response:

We believe that the Section 805(a) issues addressed by S. 2170 are distinct from ODS reform, and are properly considered in a separate bill.

7. Question:

Matson has alleged that as a result of MARAD's method of calculating ODS, APL has received an "enormous amount of subsidy above that necessary to place APL on par with its foreign competitors," and that this excess subsidy could result in unfair competition vis-a-vis Matson.

(a) Are you saying that MARAD's method of calculating ODS is not permitted under the Act?

(b) For the record, would you elaborate on why MARAD's method could result in unfair competition?

Response:

MarAd's calculation of subsidy may be fully consistent with the Act and with the goal of supporting U.S.-flag operators competing against lower cost foreign-flag carriers, yet those calculations may nevertheless unfairly advantage the subsidized operator when he competes with an unsubsidized, exclusively domestic operator. Indeed, Section 805(a) was intended by Congress to provide a second level of protection against unfair competition, even after subsidy is reduced by the statutory formula for domestic operations.

Excess subsidy has been defined as the payment of subsidy over and above the level necessary to place a recipient on a parity with its foreign competitors. Under the indexing system adopted by Congress in 1970, operating-differential subsidy (ODS) is calculated based on the differential between indexed U.S.-flag wage costs and foreign competitors' wage costs. An operator that keeps its own wage costs below the indexed costs is rewarded by receiving a subsidy windfall of up to 10% of its actual wage costs. Section 603 of the Act, 46 U.S.C. app. § 1173(c)(1)(D).

Excess subsidy may also arise from reductions in the operator's crew costs (through manning or salary reductions) which occur after January 1, the mid-point of the fiscal year and the date for which MarAd determines the operator's wage costs. 46 C.F.R. § 282.21 (1989). The differential may be further overstated by changes in exchange rates and increases in foreign wage costs that are ignored by the ODS calculations. Under the agency's current regulations, it looks at the ratio of foreign to U.S. crew costs as of January 1 of the preceding fiscal year, and uses the prior year average exchange rates for converting foreign currencies into the U.S. currency equivalent. Whenever foreign wage costs rise faster than the U.S. costs, or the dollar falls against the foreign currencies, it creates a windfall for the subsidized operators. These excess subsidy amounts are in addition to the 10% windfall available from the indexing system.

All of the windfall subsidy is available to the subsidized operator for use to support its domestic operations, resulting in patently unfair competition with an exclusively domestic operator.

8. Question:

(a) What is "back-haul" pricing?

(b) In the trans-Pacific trades, would "back-haul" pricing give a mixed service operator an advantage over a domestic, Mainland-Hawaii operator?

Response:

"Back-haul" pricing is the ability of a carrier to price on an incremental cost basis on its "back-haul" movement. In nearly every trade route, one of the two legs is the "head-haul," or heavy cargo leg. The revenue from the head-haul carriage covers most of the carrier's fixed costs, so that back-haul cargo need only be priced to cover incremental costs and make a contribution to fixed costs.

In the pattern of trade that has predominated for the last decade, the head-haul in the trans-Pacific trades is the eastbound, high-value import cargo to the U.S. In the mainland-Hawaii trade, by contrast, the head-haul is in the opposite direction, in the westbound movement to Hawaii. The volume of eastbound cargo moving from Hawaii to the mainland is only one-third of the volume going outbound to Hawaii.

A subsidized mixed service operator in the trans-Pacific trades that calls at Hawaii on his westbound leg thus has a back-haul pricing advantage in carrying domestic cargo to Hawaii, as most of his fixed costs are already covered by his subsidized eastbound movement in the trans-Pacific trade. This results in a huge economic advantage for the subsidized operator.

9. Question:

If existing service in a domestic trade is adequate, which additional service is more likely to result in unfair competition or be prejudicial to the objects and policy of the Act:

Mixed service or affiliate service?

Response:

Both types of services require scrutiny under Section 805(a), but a "mixed" foreign/domestic service presents additional concerns.

First, there is the issue of unfair competition by a subsidy-backed operator. In a mixed service the voyage expenses are commingled, and there is an inherent possibility of residual subsidy benefit. A mixed service may also "skim the cream" from the domestic trade, to the disadvantage of the dedicated domestic operators; it may create instability in the domestic trade, by its ability to shift capacity allotted between domestic and foreign cargo carried on the same vessel; and it may engage in the domestic service on a purely incremental cost basis, with its fixed capital costs covered by its subsidized foreign trade service.

Second, there is the issue of prejudice to the statutory objectives. By shifting foreign trade capacity to carriage of domestic cargo, a mixed service operation may undermine the statutory goal of promoting U.S.-flag capability in the foreign trade, even as it displaces dedicated domestic trade vessels and thereby reduces the operating merchant marine and decreases domestic shipbuilding opportunities for the domestic trade.

10. Question:

Adequacy of service--quantitative and qualitative--is, of course, a key test under S.2170.

When do you consider service in a domestic trade adequate?

Response:

The measure of adequacy can be simply stated: does all of the cargo move in the time frame required by the customer? Factors to be examined include the sufficiency of the tonnage to carry the available cargo, frequency of service, and ports served.

11. Question:

It has been said that subsidized carriers can use the benefits of subsidy to compete with Jones Act carriers.

Could you give specific examples of how this can occur?

Response:

As noted above in the response to question 7, a subsidized carrier may receive excess subsidy -- that is, subsidy above the level necessary to put it on a cost parity with its foreign-flag competitors. The excess subsidy is received as fungible dollars, which the carrier may use to offset rate cuts in competition with exclusively domestic carriers. No "diversion" is required, as all of the money is in the same pocket.

12. Question:

What percentage of your westbound cargo is tariffed at the FMC? ICC?

Response:

Approximately two-thirds of our revenues fall under FMC tariffs, and the remainder under ICC tariffs or exempt intermodal circulars.

13. Question:

If APL is given Section 805 permission to serve Hawaii from California, would it be likely that, because it is a subsidized carrier, APL could establish a rate structure that would attract Pacific Northwest cargo to its California service?

Response:

At the hearing on APL's Section 805(a) application, APL's witnesses testified that they had no current plans for direct vessel calls to the Pacific Northwest, but could carry cargoes originating there by absorbing the cost of first moving the cargo containers by truck from Seattle to Oakland. Although the cost of the overland movement would be high, APL would be in a position to absorb that cost, given its subsidy and incremental pricing advantages.

RESPONSE OF MATSON NAVIGATION COMPANY, INC. TO SUPPLEMENTAL WRITTEN QUESTIONS FROM SENATOR INOUYE FOR THE HEARING ON S. 2170 BY THE SENATE SUBCOMMITTEE ON THE MERCHANT MARINE

Justification for the Proposed Bill

1. Question:

Why, in your opinion, should the Act be changed? Have market conditions changed since 1936, when section 805 was written, that warrant a change to existing law?

- If so, how have conditions changed?
- Does the fact that APL is trying to enter the domestic trade in competition with you make this legislation essential for you?

Response:

The proposed legislation is necessary to reaffirm the policies adopted by Congress in the 1936 Merchant Marine Act: to encourage the development and maintenance of two U.S.-flag fleets, one supported by subsidy, for competition with foreign-flag carriers in the foreign trade, and one unsubsidized, for service in the protected domestic trades. Rather than change the Act, S. 2170 would reaffirm those policies to ensure proper implementation by the administrative agency. In particular, S. 2170 provides that permission under Section 805(a) for a mixed foreign/domestic service by a subsidized operator requires a finding that existing service in the domestic trade is inadequate.

S. 2170 would change existing law by barring affiliates of subsidy recipients from operating CDS-built vessels over twenty-five years of age in domestic liner service. This change is needed to avert the disastrous consequences that would follow if dozens of CDS vessels now nearing the end of their statutory lives were to be dumped in the domestic trades. That influx of inexpensive tonnage would cut off any opportunity for new building by U.S. shipyards for the domestic trade, which is the industry's mainstay for commercial work.

Market conditions have, indeed, changed dramatically since 1936, with a resulting marked reduction in the potential need, perceived in 1936, to authorize mixed foreign/domestic operations to ensure adequate domestic service. The dramatic growth in cargo volume in the domestic offshore trades has attracted a dedicated fleet for domestic service. As a practical matter, there will be few instances where liner operators must conduct a joint foreign and domestic service to establish a viable service in a domestic trade.

APL's pending application to enter the Hawaii trade on a mixed service basis, adding 25% capacity to an already adequately-served trade, makes this legislation essential for Matson. Matson has committed hundreds of millions of dollars in recent years to maintain and improve a high level of service in the Hawaii trade. This continuing investment has been made in reliance on the substantial protection that Congress intended to be provided to exclusively domestic operators by Section 805(a). The confusion in the agency concerning the proper application of the Congressional policies underlying Section 805(a) requires reaffirmation of those policies by Congress.

2. Question:

Section 805(a) does not prohibit "fair" competition. Is it your belief that this standard is too lenient or rather that the discretion involved in deciding whether the standard has been met is being abused by MarAd?

- How would you distinguish "fair" competition from "unfair" competition under existing law?

Response:

Section 805(a) prohibits proposed services that would result in either "unfair competition" or prejudice to the "objects and policy" of the 1936 Act. S. 2170 reaffirms that these standards involve findings regarding (1) adequacy of existing service, as a critical issue under the "objects and policy" standard, and (2) direct or indirect subsidy support as a factor of "unfair competition."

In the past, certain agency decisions have failed to consider the full range of unfair advantages that subsidy may provide to a subsidized operator in competition with an unsubsidized operator. These include the subsidy windfall that a subsidized operator may receive under the indexing system, by which operating subsidy may expressly exceed, up to a 10% statutory limit, the amount necessary to put the subsidized operator on a parity with its foreign-flag competitors.

Under existing law, unfair competition includes any type of competitive advantage associated with an operator's subsidized operations which it would enjoy over an exclusively domestic operator.

3. Question:

Do you endorse S. 2170 in its entirety?

- If not, what sections of the bill do you oppose?
- If you do endorse the proposed legislation then you must believe that it is proper to treat bulk operations, mixed services and affiliated services differently.
- Why do you believe that these operations should be held to different standards?

Response:

Matson supports S. 2170 as introduced. Although the overarching statutory standard is the same, the differing circumstances of bulk operations, mixed services, and affiliated services means that the application of the standard has long taken into account the different circumstances of each. Whereas liner services operate on defined trade routes with a regularly scheduled, common carrier service, bulk operators are typically chartered on a long-term or spot basis to carry ship-load cargoes for a single shipper. The common carrier services thus present a distinct issue -- whether the existing service in a particular domestic trade is adequate to carry all of the shipping public' cargo on a timely basis.

A mixed service differs from an affiliated service in that a mixed service, in which a subsidized vessel makes a domestic offshore port call while on a subsidized foreign trade voyage, not only presents an opportunity for inherent subsidy leakage where the voyage expenses are commingled, but also requires a shift of U.S.-flag capability away from the foreign trade, for which the subsidy is paid, to the domestic trade.

4. Question:

Under present law, Section 805 prohibits an ODS contractor from diverting, directly or indirectly, assets used in its subsidized operations to its domestic operations. The proposed bill would disallow service by an ODS contractor for the domestic trade if there were support to the contractor's domestic operations from subsidies received in the foreign trade.

- Why is the change in existing law necessary?
- What is the difference between the two standards, if any?

Response:

The misdemeanor clause in Section 805(a), which makes the diversion of subsidy into the domestic trade a crime, has not been as broadly construed as the question suggests. Most prominently, a vessel constructed with government subsidy is literally an asset "used in foreign-trade operations, for which a subsidy is paid by the United States," but its use in a mixed foreign/domestic service is sanctioned by the Act, provided the requirements of Sections 506, 605(a), and 805(a) are met. In addition, the decisions under Section 805(a) have long recognized that a subsidized operator's domestic operations may benefit from "residual" subsidy, even after pro-rata subsidy reduction under Sections 506 and 605(a), without purposeful "diversion" of the subsidy into the domestic trade (Matson Navigation Co. v. Connor (1966)).

The provision in S. 2170 (to require adoption of conditions on Section 805(a) permission to ensure that domestic services do not enjoy any subsidy support) provides a mechanism to carry out the intent of the Act. The difference between the current misdemeanor prohibition on subsidy diversion and the adoption of conditions to prevent subsidy support lies in the narrow interpretation placed on the misdemeanor provision.

Payback Requirement

5. Question:

Existing law requires that subsidized carriers engaged in domestic trade pay back a proportionate amount of revenue derived from the domestic portion of their voyage.

- Why, in your opinion, does this requirement not sufficiently compensate for the subsidy received by the operator?

Response:

Under Sections 506 and 605(a), construction subsidy and operating subsidy are required to be paid back and reduced, respectively, by the ratio of domestic revenues to total voyage revenues when a subsidized vessel engages in a mixed foreign/domestic service. The subsidy reduction formula provides a very rough measure by which subsidy is returned to the government when the operator engages in the protected domestic trades, rather than exclusively in the foreign trades, for which the subsidy is paid.

The Section 805(a) cases have long recognized that "residual" subsidy may remain even after application of the statutory formula. (Matson Navigation Co., Inc. v. Connor (1966)) ("It was even foreseen at the Congressional hearings that proration might not always remove all benefits of subsidy to an operator of a combination foreign-domestic service . . .").

Section 805(a)'s unfair competition standard was adopted to provide a second level of protection to ensure that no unfair competition would result even after subsidy reduction under the statutory formula.

Recent changes to the calculation of operating subsidy have made possible receipt of subsidy windfall that may provide further competitive advantages. For example, under the indexing system adopted in 1970, a subsidized operator that keeps wage costs below the wage cost index may receive up to 10% more subsidy (10% being a statutory cap) than the amount necessary to put the operator on a wage cost parity with its principal foreign-flag competitors.

6. Question:

It is my understanding that your company has had a considerable return on its investment over the last few years, and has, in fact, made a profit well over $100 million each year over the last 5 years. This has occurred at a time when other operators, including subsidized operators, continue to lose money.

- Would one not assume that there is room for competition in a service that has yielded such high returns?

Response:

Profitability is a mark of a successful company, and a company must be profitable in the expansionary period of a business cycle if it is going to survive the downturns in the cycle. In the same five years Matson has committed an equivalent amount of money in capital reinvestment in the Hawaii trade, so it can continue to provide the high level of service required by consumers and shippers in that trade. Not all carriers find the

Hawaii trade profitable; others have come and gone over the years.

The Hawaii trade, like all domestic trades, is open to entry by any unsubsidized operator, and Matson welcomes competition that enters on the same, unsubsidized basis on which it operates. Furthermore, although the question characterizes Matson's rate of return as "high", that rate of return is subject to regulation by the Federal Maritime Commission, which is delegated the authority to prescribe "just and reasonable" maximum rates.

Adequacy Standard

7. Question:

In 1960, the D.C. Circuit Court of Appeals overturned the doctrine known as "fundamental entitlement" in a case that actually discussed Matson service to Hawaii at the time. That doctrine, as described by the Board, is that "those operators who provide exclusively intercoastal services are entitled, as against primarily offshore operators . . . to whatever intercoastal cargoes they can carry."

- Does your position on this bill differ from that doctrine? If so, how?
- If it does not, why do you believe that you are fundamentally entitled to such cargoes?

Response:

The "fundamental entitlement" doctrine is quite different from the adequacy standard. Indeed, in a subsequent case involving a mixed service application, the court affirmed the rejection of the fundamental entitlement doctrine at the same time that it stressed: "Permission to enter the domestic trade by a mixed service operator will only be granted as a final *resort* when *adequate* *service* by an unsubsidized operator is unavailable" (*Matson Navigation v. Connor*) (emphasis added).

Moreover, the "fundamental entitlement" doctrine focuses on the status of the carriers, while S. 2170 looks at the adequacy of existing service as a whole that is provided to the shipping public. The doctrine provides that unsubsidized exclusively domestic operators, *by virtue of their status*, are fundamentally entitled to carry all the cargo which they have the capacity to carry, and that subsidized operators, by virtue of *their* status, should not be permitted to carry any domestic cargo which the unsubsidized operator can carry. *Pacific Far East Line, Inc.- Application for Section 805(a) Permission to call Hawaii*, 5 F.M.B. 287, 299 (1957). There is no similarity between "fundamental entitlement" and the adequacy test which is the decisional standard for grant of Section 805(a) permission under S. 2170. Under S. 2170, a subsidized operator is permitted to enter a domestic trade only if service in that trade by *existing* operators, *both* subsidized and unsubsidized, is inadequate. The decisional standard in S. 2170 focuses on whether existing service is adequate, not on the status of the operator providing the existing service, as does fundamental entitlement.

8. *Question*:

Do you believe that existing service in the trades that you serve is adequate?

- If existing service is adequate, what would be the purpose of any hearing under 805(a), as amended, when there exists sufficient tonnage to meet existing needs?

- What standards would you propose for determining whether the quantity of existing service is adequate?
- What standards would you propose for determining whether the quality of existing service is adequate?

Response:

Matson believes that the factual determination whether or not there is adequate service in the Hawaii trade is properly made in an administrative proceeding, as S. 2170 provides. Adequacy of existing service has always been an issue in Section 805(a) proceedings, and S. 2170 would simply reaffirm that standard to be applied by the agency in its evidentiary hearing. As a general matter, however, Matson submits that there is abundant evidence that the Hawaii and other domestic offshore trades are currently adequately served by existing operators and will continue to enjoy more than adequate service for the foreseeable future.

The purpose of a hearing under Section 805(a), as amended, would be to make the factual determination concerning the adequacy of existing service. This standard encompasses both the quantity and quality of service.

Quantity of service should be determined by the availability of vessel tonnage and frequency of sailings, so that the cargo offered can move in the time frame the customers require.

Quality of service should be determined by the frequency of sailings; the capacity to carry all types of cargo, e.g., roll-on, roll-off service for trailers and vehicles, as well as service for dry containers, refrigerated cargo, and conventional bulk cargo; the range of ports served; and any other special service that the market requires.

Adequacy Standard

9. Question:

In your testimony, you state that an interpretation of the current laws that would permit approval of a mixed service application, even though existing service is adequate, would be devastating to not only domestic operations but would also reduce U.S.-flag capability in foreign trades.

- Would you please elaborate on that statement?

Response:

Two principal goals of the Act are to develop and maintain an American merchant marine capable of carrying all of our domestic cargo and a majority of our foreign trade cargo. In a mixed service application, the subsidized operator proposes to use a subsidized vessel in a joint foreign/domestic service under one of the four exceptions to Section 605(a), which requires, as a general principle, that subsidized vessels operate exclusively in the foreign trades.

By allotting capacity to domestic carriage in lieu of foreign trade carriage, the subsidized operator necessarily reduces U.S.-flag capability in the foreign trade. As a consequence, the goal of carrying at least half of our import and export trade is disserved. In the circumstance that existing domestic service is found to be inadequate, the shift of capacity from the foreign to the domestic trade may be justified -- despite a reduction in U.S.-flag capability in the foreign trades -- because it advances the equally important statutory goal of maintaining a merchant marine capable of carrying all of our domestic cargo. When the existing domestic service is adequate, by contrast, granting the permission undermines the statutory goal of maintaining an adequate foreign trade fleet, but with no offsetting advancement of any other statutory policy.

Effect on Rates

10. Question:

How do rates to Hawaii from the west coast compare to rates to similar destinations for like goods?

- If such rates are higher than rates to comparable destinations, why do you believe they are higher.

Response:

Given Hawaii's unique geographic position and cargo mix, no other destination is quite "similar" for purposes of comparing rates. Nevertheless, rates to Hawaii are substantially lower than rates to certain other domestic offshore ports.

11. Question:

Have you had any rate increases that have been investigated or disapproved by the FMC?

- If so, what has been the basis for the investigation or disapproval?

Response:

The FMC has actively carried out its responsibilities for regulation of rates in the domestic offshore trades. A few years ago, the FMC not only rejected a Matson rate increase but ordered a decrease in rates. The disapproval was based on a determination that Matson's rate of return on rate base exceeded the allowable rate of 11.56%.

From 1985 to 1989, Matson's rates have risen only 4.2%, compared with a rise in the consumer price index of 19% in the same period. In January 1990 Matson filed a 3.6% general rate increase, which the FMC is now in the process of reviewing.

12. Question:

What is the role of the Federal Maritime Commission (FMC) in regulating rates in the domestic offshore trades?

Response:

Carriers in the domestic offshore trades must file their tariffs showing rates for port-to-port transportation with the FMC, and the FMC is empowered to review any rate to determine if it is unjust or unreasonable, and to prescribe a just and reasonable maximum rate. In addition, carriers are required to file annual financial reports, in a format specified by the FMC, to allow the FMC to review the carriers' rates of return.

Impact on "Mixed" and "Affiliated" Service

13. Question:

In your testimony, you state that mixed services raise concerns of greater magnitude than "affiliated" services. TOTEM expressed the opposite concern in its testimony, that is, that "affiliated" services are more of a danger to domestic operators than "mixed" services.

- Do you believe that one type of service is more destructive to Jones Act operators generally, or does the answer depend solely upon which domestic operator you ask the question of?

13. Response:

Although in both cases the subsidy-backed company will have an advantage over the exclusively domestic, unsubsidized operator, the decisions under Section 805(a) have long recognized that the distinct circumstances of a "mixed" foreign/domestic service, in which the subsidized vessel itself seeks to engage in domestic trade, presents additional concerns than simply an "affiliated" service, in which a subsidized operator proposes to affiliate with an existing unsubsidized domestic service. In a mixed service the voyage expenses are commingled, and there is an inherent possibility of residual subsidy benefit. A mixed service may also "skim the cream" from the domestic trade, to the disadvantage of the dedicated domestic operators; it may create instability in the domestic trade, by its ability to shift capacity allotted between domestic and foreign cargo carried on the same vessel; and it may engage in the domestic service on a purely incremental cost basis, with its fixed capital costs covered by its subsidized foreign trade service. Affiliation also has risks of subsidy diversion through common operating, marketing, or chandlering, but these risks are often less immediate than in a mixed service operation.

14. Question:

The effect of this legislation could be to interfere with the administrative proceeding at MarAd that would allow APL into the domestic trade - a proceeding in which they have abided by the requirements of the existing law and spent many years and millions of dollars seeking approval.

- Do you see any problem with legislatively revoking that permission that has, thus far, been initially approved in the administrative process?

Response:

When companies such as APL enter into subsidy contracts with the U.S. government, the government provides them with a contractual, 20-year commitment to subsidize their operations, and they agree to operate exclusively in the foreign trades, for which the subsidy is paid. A very narrow exception is made for calls at domestic offshore ports in the course of the subsidized foreign trade voyages, but only after the operator applies for and receives permission for such domestic trading under Section 805(a). Rather than being a matter of right, such exceptional permission is dependent upon a finding that it is consistent with advancement of the overall goals of the Merchant Marine Act.

Far from "changing the rules," S. 2170 simply reaffirms the law and policy of the 1936 Merchant Marine Act. S. 2170 does not upset any settled expectations, because there is no change in the standard on which subsidized operators could have reasonably relied. As the Maritime Administration Deputy Chief Counsel testified at the Subcommittee's hearing, adequacy of existing service has always been a factor in Section 805(a) proceedings, and S. 2170 would simply confirm that adequacy is a critical factor under the statute. In no prior mixed service case has Section 805(a) permission been granted when existing service was found adequate. S. 2170 would simply reaffirm that policy, not retroactively change the legislative standards.

When APL entered into its subsidy contract it expressly agreed to abide by subsequent legislation regarding waivers and permissions required in order to receive operating subsidy. In Part I-1(a) of its contract APL expressly agreed that "no subsidy accrued hereunder otherwise allowable under the Act shall be paid unless and until the Operator has requested and has been granted such waivers or permissions as may be required pursuant to this Agreement or the Act, or subsequent legislation having the same or similar force and effect . . . " (emphasis added). In short, APL has waived, in advance, any objection it might have about the immediate effectiveness of S. 2170.

Indeed, Matson and other domestic operators have relied on the Section 805(a) standards in making substantial capital investments to maintain a high level of service in the domestic trades. It is the potential agency deviation from Congressional policy, not S. 2170, that is inequitable, and there is no unfairness in barring a company from taking advantage of the agency's mistakes. Adequacy of existing service has always been a factor in Section 805(a) proceedings, and S. 2170 would simply confirm that adequacy is a critical factor under the statute.

Finally, it must be noted that APL and the USA group have proposed legislation as part of ODS reform that would exempt APL from meeting the Section 805(a) standards entirely, expressly overriding any administrative or judicial decision denying the permission. Unlike the USA proposal, S. 2170 does not override Section 805(a), but merely ensures its proper implementation.

15. Question:

In the event that APL is granted permission to engage in the domestic service to Hawaii what impact do you predict that would have on your service?

- What type and percentage of the trade would APL provide?
- What financial impact would this have on Matson?

Response:

In the analysis presented by APL's expert witness in the administrative proceeding, APL would capture 25% of the market, reducing Matson's market share by 20 percentage points. This would require Matson to lay up a vessel, curtail the frequency of its service, and postpone building of new vessels. APL would concentrate on the high-rated standard, dry containers moving to Honolulu, leaving Matson to carry higher cost or lower-rated cargo, including vehicles, refrigerated cargo, and cargo going at common rates to the Neighbor Islands. The introduction of 25% excess capacity would lead to rate and service instability. A rate war which caused rates to fall by 20% would reduce Matson's annual gross operating margins by $50 million or more.

Senator **Breaux**. Thank you very much. That was certainly within a reasonable time.

Stan, glad to have you, Alan. Glad to have you all here.

STATEMENT OF STANLEY H. BARER, CHAIRMAN OF THE BOARD, TOTEM RESOURCES CORP., ACCOMPANIED BY ALAN BUTCHMAN, COUNSEL

Mr. **Barer**. Thank you, Mr. Chairman. With your permission, I will try to summarize my testimony.

Mr. Chairman, members of the committee: We appreciate greatly the opportunity to appear and testify with respect to S. 2170. I want to take just a few minutes and tell you a little bit about our company. We are a Seattle-based holding company. We have three operating subsidiaries. Totem Ocean Trailer Express, or TOTE, operates a steamship service from Puget Sound to Alaska in direct competition against Crowley and Sea-Land.

Our subsidiary Foss Maritime is a tug and barge company operating about 125 vessels up and down the West Coast and in Alaska. Our Interocean Maritime subsidiary in Philadelphia crews and manages U.S.-flag vessels for a variety of vessel owners.

All of our companies, all of our assets, all of our service, is Jones Act: all U.S.-crewed, U.S.-built, all without subsidy. We have about a thousand employees, the majority of those in Alaska and in Washington State. We applaud Senator Inouye's efforts to strengthen the separation between subsidized foreign carriers and unsubsidized domestic carriers. However, the bill does not go far enough. In fact, it creates a real serious problem for us.

For the past 54 years, there has been a single standard under section 805 treating mixed service and affiliated service by subsidized carriers the same. In 1936 Congress appropriately recognized that the threat to a non-subsidized Jones Act carrier from a subsidized carrier was the same whether it was a mixed service that was offered or an affiliated service.

Now, we concur wholeheartedly with Senator Inouye and with Matson that the application of that standard has deteriorated since 1936, and we believe wholeheartedly that that standard should be strengthened. But it ought to be strengthened for all trades, for affiliated service as well as mixed service.

We are in as great a jeopardy as is Matson, but we face potentially affiliated service in Alaska. Let me tell you something about our situation in Alaska. Senator Inouye raised the issue of whether "a comfortable margin of supply over demand" was an appropriate standard of adequacy.

Last year in the Alaska trade, even with the extra cargo resulting from the cleanup effort from the Exxon Valdez incident, the overcapacity in our Jones Act trade was 50 percent. Both of our competitors, Sea-Land and Crowley, under the proposal of the USA group intend to become subsidized. We would be the only non-subsidized carrier in the Alaska trade.

Our subsidized competitors would have two and a half times our capacity. So we feel very concerned.

We oppose this legislation now because we do not want to see the rules changed in midstream. For 54 years there has been a single standard. We have invested under that single standard.

If we are going to take care of mixed service, let us take care of affiliated service at the same time. It is amazing. There are very few things that this industry ever agrees upon, but in this case the Congress since 1936, all of the industry, and the Maritime Administration even, have always agreed there should be a single standard under 805 for both affiliated service and mixed service.

We do not want to see that changed now. So while we are supportive of the Senator's efforts to strengthen it, we want it to be strengthened for everyone. We are very concerned that, if Congress changes it now for mixed service and does not take care of affiliated service, Congress is not going to deal with that issue again soon.

And what the problem is, if you have "adequacy" written into the statute for mixed service but not for affiliated service, you know what the lawyers are going to say: inadequacy is not required as a condition for affiliated service. Unfortunately, for that reason we cannot support the legislation as drafted.

We have suggested an amendment to make the new standard apply across the board and also some suggested report language, and with that amendment and report language, we would wholeheartedly support this legislation.

Thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF

TOTEM RESOURCES CORPORATION

BEFORE THE SUBCOMMITTEE ON MERCHANT MARINE
COMMERCE, SCIENCE AND TRANSPORTATION COMMITTEE

UNITED STATES SENATE

CONCERNING

S.2170

May 16, 1990

Mr. Chairman, members of the Subcommittee, and guests: I am Stanley H. Barer, Chairman of the Board of Totem Resources Corporation. I appreciate the opportunity to submit this statement to the Subcommittee concerning S.2170.

Totem Resources Corporation applauds Senator Inouye's efforts to strengthen the separation between subsidized foreign carriers and unsubsidized domestic carriers which Congress intended. We believe that S.2170 is a good first step toward strengthening Section 805(a) of the Merchant Marine Act of 1936, but more should be done.

I. Totem Resources Corporation's Role In The Unsubsidized Domestic Trades.

I would like briefly to describe Totem Resources Corporation ("TRC") and its role in the unsubsidized domestic trades. TRC is a Seattle-based holding company for three maritime companies:

- Totem Ocean Trailer Express ("TOTE") is an unsubsidized carrier operating two U.S. built, U.S. flag vessels in the trade between the Pacific Northwest and Alaska. TOTE's vessels have been built and operated without a single dollar of subsidy.

- Foss Maritime is a Jones Act tug and barge company active up and down the entire West coast including Alaska. It operates a fleet of over 125 modern, well-equipped vessels, all of which were built in U.S. yards and are U.S. flag and U.S. crewed.
- Interocean Management Corporation is a Philadelphia-based company which provides ship management and operations services for U.S. flag vessels. It not only manages ships for a variety of U.S. flag carriers but also manages ships for the United States Maritime Administration.

These three companies provide jobs for approximately one thousand employees, primarily in the States of Alaska and Washington.

II. Section 805(a) Needs To Be Strengthened.

TRC supports the separation of subsidized and unsubsidized carriers created by the 1936 Act. We have no objection to subsidizing United States carriers so they can compete fairly with foreign carriers in international trades, but we strenuously object to allowing those subsidized carriers to use the benefits of their subsidies to compete with the Jones Act carriers, which have never had the benefit of subsidy dollars. All TRC asks for is a level playing field, but as Senator Inouye correctly stated when he introduced S.2170, the intended division between subsidized foreign and unsubsidized domestic carriers has been eroded and manipulated in ways that, in the Senator's words, make for an uneven playing field and undermine the objects and policy of the 1936 Act.

A. Competition Between Subsidized Carriers and Jones Act Carriers Is Inherently Unfair.

Any subsidized carrier which is allowed to enter a Jones Act trade will have the practical business advantages of increased staying power and ability to take economic risk. The Administrative Law Judge who heard four days of testimony in the Atlantic Bear case concluded that "the record is replete with impressive economic testimony which evidences the inherent advantage stemming from subsidy which . . . provides that operator with an amount of 'staying power' [and] allows him to withstand a certain amount of economic adversity." Aeron Marine Shipping Co., Dkt. No. S-724 (Initial Decision at 21-22). The ALJ who heard APL's pending application to serve Hawaii acknowledged that "in a general sense the subsidy benefits might make APL a stronger company" regardless of whether the subsidy was diverted to a domestic trade. American President Lines, Ltd. 805(a) Application, West Coast-Hawaii, Dkt. No. S-801, 25 SRR 486, 509 n.11 (initial decision 10-2-89).

This common sense conclusion confirms something every businessperson knows: If the government hands a company several million dollars every year, the company can afford to take that much more economic risk. Thus cross subsidy and subsidy leakage are inevitable whenever a carrier both receives subsidy and operates in a domestic trade.

B. MARAD Has Weakened The Separation Between Subsidized And Unsubsidized Carriers Which Section 805(a) Was Intended To Assure.

MARAD's recent interpretations of Section 805(a) have undermined its effectiveness. Congress intended Section 805(a) to assure that if a subsidized carrier participated in a Jones Act trade on an unsubsidized basis, it would not be able to use the inherent advantages of its subsidy to compete unfairly with the Jones Act carriers. MARAD, however, interprets this section as allowing a subsidized carrier to enter an unsubsidized trade if (1) it sets up a separate corporation and (2) it prevents commingling of funds. Once these formalities of corporate organization are completed, the subsidized carrier is free to operate in Jones Act trades unless the unsubsidized carriers prove that (A) existing carriers will be driven out of the trade; (B) new entrants will not replace them; and (C) as a result there will be insufficient capacity in the trade in the long run. Aeron Marine Shipping Co., 22 SRR 1547 (1984), aff'd, Puerto Rico Maritime Shipping Authority v. Dole, 619 F.Supp. 1312 (D.D.C. 1985) vacated and remanded as moot, Matson Navigation Co. Inc. v. United States, 825 F.2d 402 (D.C. Cir. 1987). This is of course almost impossible to prove.

The Administration also has weakened or attempted to weaken other statutory protection against subsidized competition in domestic trades. Sections 506 and 605 of the 1936 Act were intended to permit incidental carriage of domestic cargo by vessels engaged in foreign trade under narrowly limited circumstances, and only if the subsidized operations would be consistent with the purposes and policies of the Act and would not result in unfair competition with domestic operators. The agencies' interpretations of these provisions, however, would allow subsidized carries to use federal tax dollars to compete in trades which Congress intended to be free from subsidy.

For example, in 1983, the Department of Transportation ruled that APL could use subsidized vessels to carry domestic cargo to and from Alaska, so long as the cargo was loaded onto the vessels at the foreign port of Vancouver, British Columbia, approximately 120 miles north of Seattle. This interpretation was subsequently modified by DOT and, after modification, was challenged in court by TOTE, Sea-Land, and others, and was reversed. Sea-Land Service, Inc. v. Dole, 596 F.Supp. 1143 (D.D.C. 1984). On January 31 of this year, MARAD allowed Sea-Land and PRMSA to operate CDS vessels in the Puerto Rico trade as long as the vessels carried one-fourth foreign cargo. This action is currently being challenged in court. Marine Transportation Services Sea-Barge Group, Inc. v. Skinner, (Civ. A. No. 89-2278 D.D.C.).

As Senator Inouye stated when introducing S.2170, the Administration and MARAD appear to have used these interpretations as devices to ease restrictions on subsidized operators, thereby attempting to compensate for the inability to reform the ODS system. This should not be tolerated, because it undermines the "distinctions Congress intended to exist between subsidized and unsubsidized operators, and between Jones Act and non-eligible Jones

Act operators." Congressional Record--Senate S1612 (February 26, 1990).

III. S.2170 Should Strengthen Section 805(a) In Several Additional Respects.

TRC strongly agrees with the purposes of S.2170 -- reversing the erosion of Section 805(a) and strengthening that section. The changes which S.2170 would make are important and beneficial steps in assuring that Section 805(a) serves its intended purpose for Hawaii. However TRC also believes that assurances of a level playing field are at least as necessary in Alaska as they are in Hawaii. For that reason, TRC believes S.2170 should be amended so that (A) its safeguards will apply equally to all domestic carriers in all domestic trades; (B) it will guard against wasteful and inefficient overtonnaging; and (C) permission would be required for any material changes in service.

A. The Section 805(a) Standard Should Be The Same For All Types Of Services In All Domestic Trades.

All applications for permission to participate in domestic trades should be decided under the same standard, regardless of what trade or type of service is involved. Under S.2170, however, "mixed service" (i.e. a route which carries both domestic and foreign cargo, such as APL's proposed Hawaii service, which would continue to Asia) is not authorized unless "the existing service provided in the coastwise or intercoastal trade by all vessels is inadequate."

On the other hand, "affiliated service" (i.e. wholly domestic service by a company which receives subsidy for its foreign routes, e.g., Sea-Land's Alaska service or Crowley's Alaska service, if those carriers received subsidy) would be permitted even if the existing unsubsidized service is adequate.

1. A Weaker Standard For Affiliated Service Than For Mixed Service Is Unjustified.

We believe there is no justification for a legislative standard that makes it easier to subsidize Sea-Land's and Crowley's affiliated services in Alaska than to subsidize APL's mixed service in Hawaii. Simple equity requires equal treatment for all domestic trades. An unsubsidized Jones Act operator should not be treated as a second class citizen simply because its subsidized competitors would be operating affiliated services (with all the advantages of integrated operations) rather than mixed services.

2. Affiliated Services Compete More Directly With Jones Act Carriers Than Mixed Services.

In fact, subsidized competitors have a greater effect on the Jones Act carriers when they operate as affiliated services than when they operate as mixed services. An affiliated service competes head to head with Jones Act carriers for every piece of cargo in the trade. Its entire business is identical to that of the Jones Act carrier. A mixed service, on the other hand, by definition provides domestic service only as an adjunct to its foreign service. Its business overlaps with the Jones Act carrier, but its marketing and competitive energies are divided between its domestic and foreign services.

3. Carriers Currently Seeking Subsidy Have In The Past Sought Severe Restrictions On Affiliated Services.

The carriers who participate in Jones Act trades have previously opposed attempts to operate an affiliated service, even when the operations would have been totally separate. In late 1985, TRC proposed to acquire Lykes Brothers (a subsidized carrier) and filed an application for permission to continue TOTE's unsubsidized Alaska operations as an affiliated service under Section 805(a). Notwithstanding TRC's assurances in its application that (a) Lykes's ODS funds would not be diverted to TRC's domestic operations, and (b) ODS funds would not benefit vessels to be operated in the domestic service, both Sea-Land and Crowley claimed that the proposed transaction might threaten their interests.

Sea-Land stated that if the acquisition were concluded, TOTE's operations would be "competition aided by subsidy" and requested a hearing to determine the effect of the proposed acquisition on Sea-Land's then-unsubsidized Alaska operations. Crowley stated that the domestic trades were overtonnaged, and that the proposed acquisition "could have [a] long term significant adverse impact" on Crowley's domestic operations. Crowley specifically demanded that TRC agree that Lykes and TOTE, (i) keep their CCF funds segregated; (ii) "not share any terminal or other physical facility;" and (iii) that Lykes would "not advance funds or otherwise lend monies or credit" for the benefit of domestic operations. While we were able to satisfy Crowley's concerns through negotiations, we were unsuccessful with Sea-Land and abandoned our acquisition rather than spend years litigating a Section 805(a) application.

4. Proposed Amendment.

TRC has prepared the attached amendment to S.2170 which would eliminate the double standard and treat mixed and affiliated services equally. Our amendment would not change S.2170's standard for mixed services; it merely applies that standard to affiliated services as well. Under our amendment any domestic service by a subsidized carrier -- whether mixed service or affiliated service -- would be prohibited unless the existing service was inadequate. Anything less would perpetuate what Senator Inouye aptly described as the "serious gaps in logic of a maritime policy which has as its object the development of a merchant marine sufficient to carry a 'substantial' portion of U.S. foreign commerce, and yet permits subsidized vessels to solicit domestic cargo when the U.S.-flag share of the U.S./foreign trades stands at 17%." Congressional Record S1615 (February 26, 1990).

B. Federal Funds Should Not Be Used To Subsidize Overcapacity.

TRC strongly believes that the "adequacy of service" test in S.2170 should preclude subsidizing operations which would create overcapacity. Subsidizing companies whose vessel operations create substantial overcapacity is bad for consumers because the costs of operating unneeded vessels will ultimately be paid by the shipping public. Moreover, operating with excessive overcapacity is always inefficient and bad public policy. The losses from these inefficient operations in the domestic trade are a drain on the financial resources of the companies receiving subsidy. The federal government should not be subsidizing companies whose unsubsidized operations weaken them financially.

TRC strongly agrees with Senator Inouye's statement that MARAD has weakened restrictions on subsidized carriers in order to compensate for the inability to reform the ODS system. Congressional Record--Senate, S1612 (February 26, 1990). To prevent such interpretive manipulation in the future, we believe Congress must give clear and objective guidance to MARAD on how to assess the adequacy of service, and in particular on the need to avoid overtonnaging. (The initial decision in APL's application to serve Hawaii concedes that "no specific definition can be gleaned . . . as to what is meant by adequacy of service." 25 SRR 486, 495.) The guidance could be included in the committee report, and we have attached language to accomplish this.

C. Changes In Service Should Require A New Section 805(a) Proceeding.

S.2170 should be amended to close a loophole in current Section 805(a). Nothing in Section 805(a) prevents a carrier from receiving permission based on one level of domestic service, and then turning around the next day and dramatically changing the vessels, capacity, ports called, or frequency of its domestic service. This makes a mockery of the requirement of obtaining permission after a hearing.

Sea-Land and Crowley both raised similar concerns when TRC proposed to acquire Lykes in 1985. In response to TRC's Section 805(a) application, Sea-Land urged MARAD to "recognize that any future actions taken by either Lykes or TRC that change their domestic service assets and service profile" would require a new Section 805(a) proceeding. Crowley's filing in the same proceeding also requested a new Section 805(a) proceeding if TRC commenced service in a new domestic trade.

TRC's attached amendment would resolve the shared concern of Sea-Land, Crowley, and TRC on this point by closing this loophole in Section 805(a). It does this by providing that a new Section 805(a) proceeding is required whenever a subsidized carrier makes any material change in the vessels, capacity, domestic ports called, or number or frequency of sailings.

IV. S.2170 Should Address Conditions In Alaska, Which Require Section 805(a) Standards At Least As Strict As Those Required In Hawaii.

The unique competitive conditions which TOTE faces in Alaska today illustrate the critical importance of (a) applying S.2170's "inadequacy of service" standard to affiliated services as well as mixed services and (b) assuring that federal tax dollars are not used to subsidize overcapacity. The double standard contained in S.2170 as currently drafted is unsuitable for Alaska, where the potentially subsidized affiliated services of Sea-Land and Crowley would dwarf TOTE and leave it as the only unsubsidized carrier to the Alaska Railbelt, and where overcapacity was nearly fifty percent in 1989.

Although Matson is much larger than the proposed service of its potentially subsidized competitors in Hawaii, the attached tables show that in Alaska the opposite is true. In Hawaii, Sea-Land's mixed service would have less than a quarter of Matson's capacity, and even with the addition of APL, the combined capacity of the mixed services would be about half of Matson's. Sea-Land and Crowley's combined capacity in Alaska, on the other hand, is more than double TOTE's capacity.

Sea-Land, for example, seeks to become subsidized even though (1) it is already part of the CSX Corporation, which has over $13 billion in assets; (2) Sea-Land is the largest U.S. flag carrier, operating more than sixty ships world-wide, and earning over a billion dollars a year in revenue; and (3) it operates the three newest and largest Jones Act ships in Alaska, with a combined capacity over two-and-one-half times that of TOTE's two vessels. Handing millions of subsidy dollars to the largest Jones Act carrier would turn the policy of the Merchant Marine Act of 1936 on its head and would be devastating for TOTE.

The problem of overcapacity is also much more severe in Alaska than it is in Hawaii. As the attached tables illustrate, in 1989 Alaska had approximately 44,000 FEU's of excess capacity (almost 50%). Based on the data contained in the ALJ's initial decision concerning APL's application to serve Hawaii,[1] however, that trade would have less that 4,000 FEU's of excess capacity in 1990 without APL (3%), and would have approximately 32,000 FEU's of excess capacity if APL is included (27%). It makes no sense for the federal government to subsidize the over 90,000 FEU's of affiliated service which Sea-Land and Crowley would provide in the Alaska trade -- a trade which had over fifty percent overcapacity in 1989 notwithstanding the surge in cargo attributable to clean-up of the EXXON VALDEZ oil spill.

Unless S.2170 is amended to eliminate the double standard for mixed and affiliated services, and to address the problems of overtonnaging and changes in service discussed above, S.2170

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1. MARAD Docket S-801, 25 SRR 486. In that proceeding, Matson, APL, and Sea-Land presented their own estimates of cargo volume and capacity in the Hawaii trade. Because the estimates were disparate, and because the ALJ did not make specific findings on these points, the figures contained in this statement and the attached tables reflect averages of the figures presented in S-801.

provides no solution for Alaska. In fact, enacting S.2170 as currently drafted would be worse for TRC than taking no action at all. By addressing the Section 805(a) issues in Hawaii, but not in Alaska, S.2170 creates the illusion that the problems have been solved when they have not. Moreover, S.2170 divides the constituents of Section 805(a) and eliminates the incentive for all interested parties to work together to resolve these issues in ways that are fair to all interests.

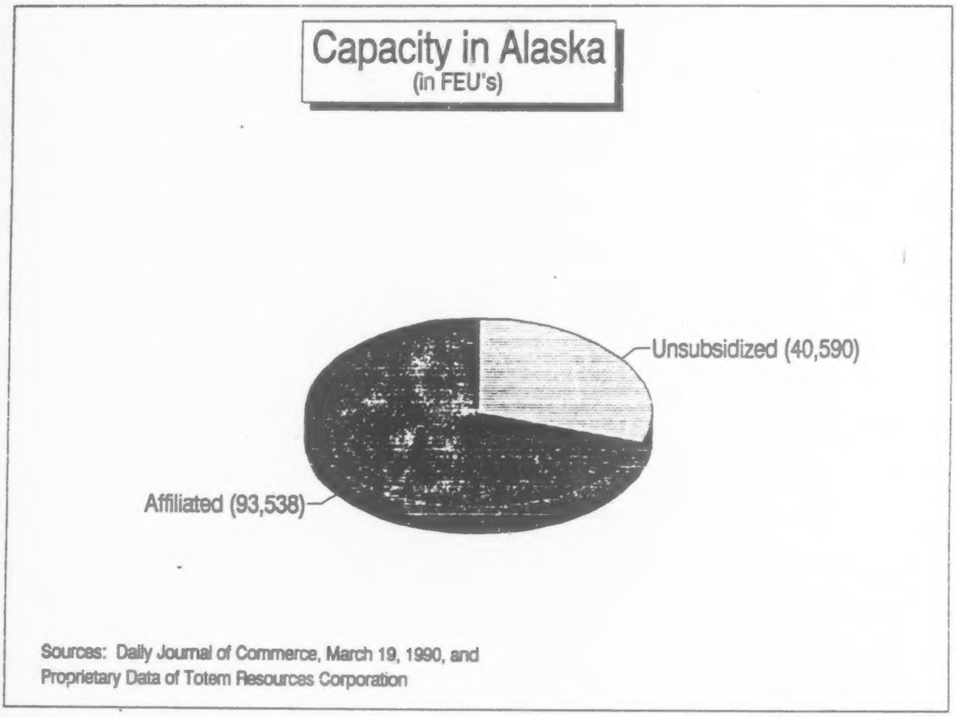
Our company is committed to working with carriers, shippers, and maritime labor to reach fair compromises and solutions to the problems facing our industry, but we cannot support legislation which corrects a statutory problem for one carrier, but not for other carriers whose interest in the same problem is equally substantial. Accordingly, we regret to say that TRC opposes S.2170 in its present form.

V. Conclusion

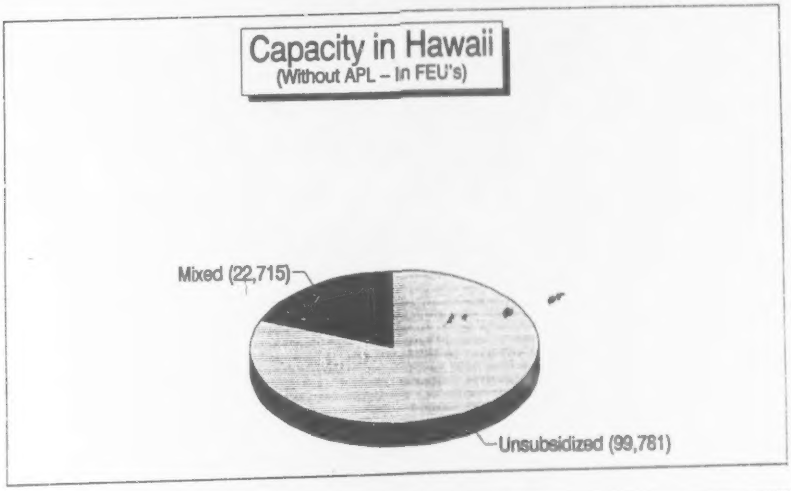
While TRC certainly agrees that the protection which S.2170 affords Matson is appropriate, we also believe a strengthened Section 805(a) is needed in Alaska at least as much as in Hawaii. If Sea-Land and Crowley receive subsidy for their integrated domestic and foreign operations as proposed, TOTE's position will be far weaker than Matson's. TOTE's capacity would be less than half of the capacity of the affiliated services. Furthermore, overcapacity is a much more serious problem in Alaska than it is in

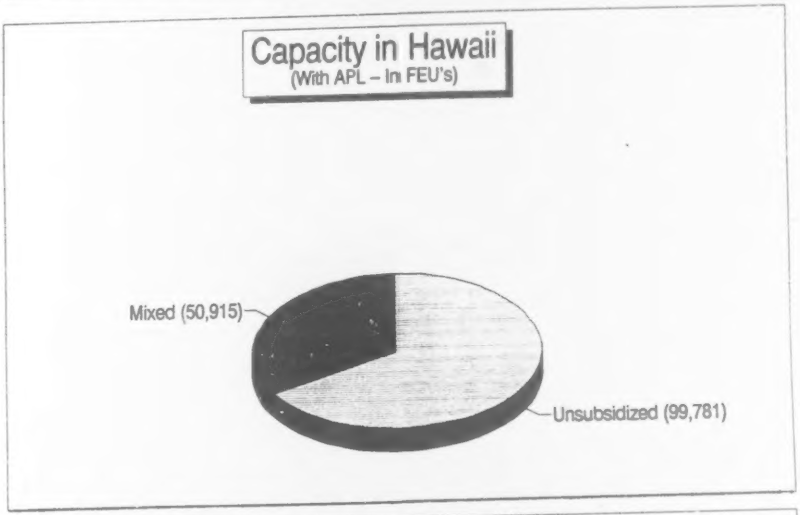
Hawaii. At a minimum, therefore, the Section 805(a) standard for affiliated services like those in Alaska should be at least as strict as the standard for mixed services like those in Hawaii, and should clearly prohibit subsidy which would lead to overtonnaging.

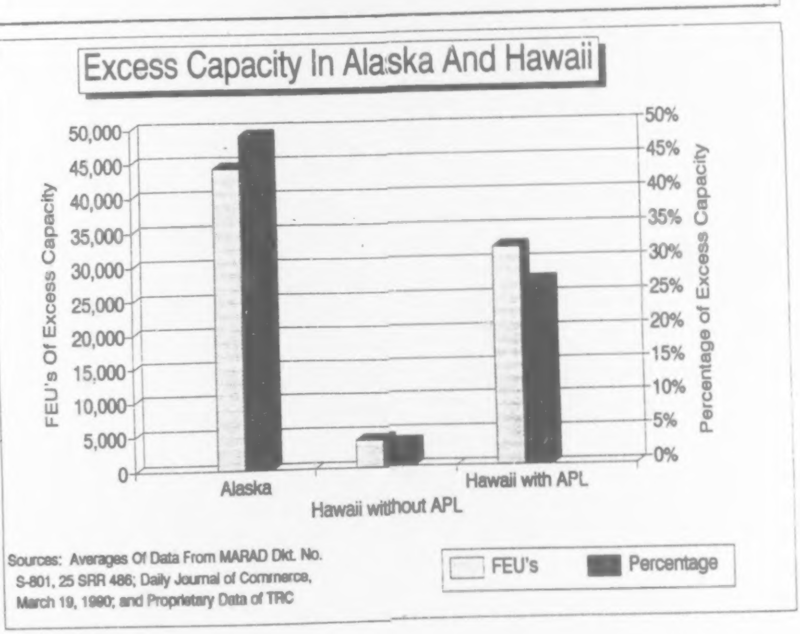
Thank you for this opportunity to present TRC's views.



Sources: Daily Journal of Commerce, March 19, 1990, and Proprietary Data of Totem Resources Corporation







Sources: Averages Of Data From MARAD Dkt. No. S-801, 25 SRR 486; Daily Journal of Commerce, March 19, 1990; and Proprietary Data of TRC

The following are responses of Stanley H. Barer, Chairman of the Board, Totem Resources Corporation, to additional questions submitted to Mr. Barer with respect to S.2170 by Senator Inouye.

1. Adequacy of service-quantitative and qualitative-is, of course, a key test under S.2170.

When do you consider service in a domestic trade adequate?

Adequate service exists when the carrying capacity of existing service is sufficient, on the average, to carry the cargo volume in the trade. For example, in highly seasonal trades, it is reasonable and normal for there to be times when existing capacity levels may not meet the peaks of demand for a short period of time, but this would not indicate that the existing service is inadequate. On the contrary, it would be inefficient and inappropriate to require overcapacity for possibly ten months of the year in order to have sufficient capacity to meet the demands of a few weeks during the year. High seasonal demands should be met by incremental short term entries into the trade that will not result in an overcapacity situation for most months of the year. As we have stressed, we believe that overcapacity is a dangerous and destabilizing situation which ultimately leads to a decline in competition through failure of carriers to be able to sustain themselves and a spiraling in rates in order to try to meet costs with decreased load factors. We have suggested to the Committee report language for S.2170 that would generally provide that the Secretary should not approve any application under Section 805(a) if addition of the service applied for would, at the time that service commenced, result in more than 15% overcapacity in the relevant trade. Following is the full text of our suggested Committee report language on this point:

> "The Committee intends that existing service not be found inadequate under Section 2 if there is significant overcapacity in the trade. It makes no sense for the federal government to subsidize vessel operations which create overcapacity. Operating with excessive overcapacity is always inefficient and bad public policy. The losses from these inefficient operations in the domestic trade are a drain on the financial resources of the companies receiving subsidy. The federal government should not be subsidizing companies whose unsubsidized operations weaken them financially.

In general, the Committee expects that the Secretary would not approve an application under this Section if addition of the service applied for would, at the time such service commenced, result in more than 15% overcapacity in the relevant trade. The Committee further expects that when considering which services to include in a trade for purposes of determining whether an application would result in overcapacity, the Secretary will include all services which are actual or reasonably viable potential competitors for a material portion of the cargo likely to be carried in the service for which permission is sought.

In determining whether service is inadequate, the Committee intends for the Secretary to consider whether the carrying capacity of the existing service is sufficient, on the average, to carry the cargo volume in the trade. For example, in seasonal trades it is reasonable and normal for there to be times when the existing service cannot meet the peaks of demand for a few weeks, and this does not indicate that existing service is inadequate. Indeed it would be inefficient and inappropriate to introduce enough capacity to meet the highest peaks of demand, because that would result in wasteful overtonnaging during the balance of the year."

2. (a) Under present law, subsidized carriers cannot offer mixed service to Alaska, but they could offer affiliate service - am I correct?

   (b) Currently, Alaska is served by three unsubsidized carriers - Tote, Sea-Land, and Crowley. Is any subsidized carrier offering "affiliate" service?

   (c) So the potential threat of affiliate service which Tote perceives, could only materialize when and if ODS reform is enacted. Whereas the stability in the Mainland-Hawaii trades from "mixed service" is more immediate and is not contingent upon enactment of ODS. My question is: couldn't Congress consider the problem of affiliate service in Alaska when it considers the proposal which will create the problem, i.e., ODS reform?

It is correct that the Alaska trade is currently served by three unsubsidized carriers - Tote, Sea-Land and Crowley; that under present law subsidized carriers cannot offer mixed service to Alaska but rather affiliated service; and that currently no subsidized carrier is offering "affiliate" service in the Alaska trade. However, the threat of affiliate service which Tote faces currently exists and is not dependent upon when or if ODS reform is enacted. Currently, any existing subsidized carrier could propose affiliated service to Alaska. Tote has faced in the past and faces at all times the threat of the Department of Transportation approving a proposal by any subsidized carrier that domestic cargo be carried by that subsidized carrier in the Alaska trade. For example, in 1983, the Department of Transportation ruled that APL, a subsidized carrier, could use subsidized vessels to carry domestic cargo to and from Alaska, so long as the domestic cargo was loaded onto the subsidized vessels at the port of Vancouver, British Columbia, just across the border from the state of Washington. After a lengthy legal battle, Tote and other Jones Act carriers were able to convince the federal courts to reverse the Administration's ruling. Sea-Land Service, Inc. v. Dole, 596 F.Supp. 1143 (D.D.C. 1984). Additionally, on January 31st of this year, the Maritime Administration allowed the operation of CDS vessels in the Jones Act trade to Puerto Rico so long as the vessels carried one-fourth foreign cargo. This is currently being challenged in Court. These two examples show that Jones Act carriers in Alaska as well as the other trades are subject to continuing efforts by existing subsidized carriers to carry domestic cargo in the Jones Act trades.

The threat is not dependant upon ODS reform, but rather is exacerbated if the ODS reform proposal of the U.S.A. group is adopted. This is because the U.S.A. proposal includes provisions which would allow both Sea-Land and Crowley to receive subsidy and continue to operate in the various Jones Act trades including Alaska. Thus it is not ODS reform which will create the problem of affiliated service. The problem already exists and we have already been fighting efforts through the years by the Maritime Administration to allow subsidized carriers to intrude into the Alaska trade. Accordingly, it would be inappropriate, we believe, for Congress to delay addressing the 805 standard for affiliated service until it may or may not act upon ODS reform. Because Congress has since 1936 always insisted upon a single standard under 805(a) for both mixed service and affiliated service, we believe that any change in that standard should cover both affiliated and mixed services. For Congress to make a decision now that subsidized carriers may provide a mixed service only if existing service is inadequate, and by omission to allow subsidized carriers to provide affiliated service even when existing service is adequate, would be a tempting invitation for all subsidized carriers to enter into affiliated service and put Jones Act carriers to Alaska in an untenable position.

3. Under S.2170, all applications of common carriers for Sec. 805 permission would be required to "disclose the nature and scope of operations proposed to be conducted in coastwise or intercoastal trade."

In Aeron Marine, I believe the Secretary of DOT held that an applicant need not specify its proposed operations.

Would you please give the Subcommittee your views on the "pros" and "cons" of the provision in S.2170?

We strongly support the provision in S.2170 to require specificity as to the nature and scope of operations proposed to be conducted in coastwise or intercoastal trade. Currently it is our understanding that the statute does not clearly require that the nature and scope of operations proposed be detailed, and we believe the language proposed in the bill on this subject is vitally needed. But we suggest that the language should even go further and in our testimony have suggested an amendment to S.2170 that would provide additionally that "... permission shall also be required for any material change in vessel(s), capacity, domestic port(s) called or number of frequency of sellings of such domestic intercoastal or coastwise service.". The necessity for this suggested amendment is clear in that once permission is now obtained by a subsidized carrier under 805(a), there is not a statutory requirement that any change in the service profile require new permission. Thus once permission is obtained changes could be made in the frequency or capacity of the vessels without the statutory necessity for new permission. We respectfully request that the Committee include our suggested amendments if the bill is reported.

SHB/788/AN9

The following are the responses of Stanley H. Barer, Chairman of the Board, Totem Resources Corporation, to additional questions with respect to S.2170.

1. Is your company in any way harmed by the current "unfair competition" standard used to determine whether mixed or affiliated services should be allowed?

If so, how?

Our subsidiary, Totem Ocean Trailer Express, Inc., which provides a Jones Act service between Puget Sound and Alaska, is directly affected by the current "unfair competition" standard used to determine whether either mixed or affiliated service should be allowed. The lower 48 to Alaska trade is a pure Jones Act trade currently consisting of only unsubsidized Jones Act carriers. However, the lax "unfair competition" standard maintains an ongoing threat to the stability of that trade and increases substantially the risk of entry into that trade by a subsidized carrier. For example, in 1983 the Department of Transportation ruled that APL, a subsidized carrier, could carry domestic cargo to and from Alaska. While our company, Sea-Land and others fought this administratively, it was not until we reached the Federal Courts that we were able to overrule the Administration on this matter and prevent competition in the carriage of domestic cargo by this subsidized applicant. Additionally, two of the Jones Act carriers currently in the trade (Sea-Land and Crowley) have proposed that they should become subsidized and be allowed to continue their current Jones Act services. The way that the Maritime Administration now interprets 805 is to allow a subsidized carrier to enter an unsubsidized trade if (1) it sets up a separate corporation and (2) it prevents co-mingling of funds. Once these formalities of corporate organization are completed, the subsidized carrier is free to operate in Jones Act trades unless the unsubsidized carrier has proved (a) existing carriers will be driven out of the trade; (b) new entrants will not replace them; (c) as a result there will be insufficient capacity in the trade in the long run. Aeron Marine Shipping Co., 22 SRR 1547 (1984), aff'd, Puerto Rico Maritime Shipping Authority v. Dole, 619 F.Supp. 1312 (D.D.C. 1985) vacated and remanded as moot, Matson Navigation Co. Inc. v. United States, 825 F.2d 402 (D.C. Cir. 1987). This burden of proof is of course almost impossible to meet.

2. Why do you believe the "adequacy of service test" should be applied to affiliated as well as mixed service?

We believe that the "adequacy of service test" should be applied to affiliated as well as mixed service for the very reasons that Congress drafted 805(a) in 1936 to apply a single standard for measuring applications by subsidized carriers whether the service proposed was mixed or affiliated. Congress recognized in 1936, as has the entire industry since then as well as the Maritime

Administration, that competition by a subsidized carrier was inherently unfair to Jones Act carriers whether the subsidized carrier service was mixed or affiliated. To now require a stronger test for mixed service than affiliated service is to throw out 54 years of consistent position by the Congress, the industry and the Maritime Administration and to place Jones Act carriers facing affiliated subsidized service in an untenable position. If the adequacy of service test applies only to mixed service and not affiliated service, it is clear that the Maritime Administration will allow subsidized operators to provide affiliated service in direct competition with Jones Act carriers whether or not the Jones Act carriers are providing adequate service. This would violate the policy of the 1936 Act and could well lead to the demise of the Jones Act carriers.

3. It is my understanding that Section 605 of the Merchant Marine Act of 1936 does not permit mixed service to Alaska.

Is that correct?

How is the situation in Alaska different than the situation in Hawaii with regard to domestic operations by subsidized carriers?

It is correct that Section 605 of the Merchant Marine Act of 1936 does not permit mixed service to Alaska. The State of Hawaii is specifically authorized in Section 605 as a point for mixed service while the State of Alaska is not so referenced. As a result, service in Alaska by subsidized carriers would be in the form of affiliated service. Under the 1936 Act, affiliated service by subsidized carriers in a Jones Act trade has been subject to the identical standard under Section 805 as has mixed service by subsidized carriers. The reason for this is that affiliated service presents at least as substantial a risk to Jones Act carriers as does mixed service.

4. You have stated in your testimony that a Jones Act operator should not be treated as a second class citizen simply because its subsidized competitor would be operating affiliated rather than mixed services. Don't you, however, in fact, have an advantage over domestic carriers that operate in the trades in which mixed service may be authorized under Section 605?

A Jones Act operator facing the affiliated service of a subsidized competitor is certainly not at an advantage over a domestic carrier that faces mixed service and, in fact, faces an even stronger threat than does the domestic carrier facing mixed service. In affiliated service the subsidized carrier competes directly with the Jones Act carrier 365 days a year, round trip, for every piece of cargo in the trade. In contrast, a mixed service, by definition, provides domestic competition only as an adjunct to its foreign service. Its business only partially overlaps with the Jones Act carrier but its marketing and competitive energies are divided between its domestic and foreign services on the same voyage. As the mixed carrier is involved in an ongoing sailing in foreign trade, it cannot compete directly for round trip service, as can an affiliated operation. In both mixed service and affiliated service situations, the Jones Act carrier faces a competitor who is subsidized by the United States government, perhaps at a level as much as 50 or 60 million dollars a year. In the mixed service situation the subsidized carrier is competing on a part time basis with the Jones Act carrier. In the affiliated service situation the subsidized carrier is competing on a full time basis, round trip, against the Jones Act carrier for all of the cargo in the trade.

5. In your testimony you state that overcapacity is bad for consumers because the costs of operating unneeded vessels will ultimately be paid by the shipping public. It would seem to me that the more carriers there are in a trade, the more competition there is and the lower the rates would be.

Do you disagree with this statement? If so, why would this be true?

You must distinguish between the benefits of competition and the detriment of overcapacity. Strong competition does, in fact, lead to lower rates and better service in all trades. However, the benefits of competition should not be attributed to an overcapacity situation. In an overcapacity situation the benefits of competition are lost and, in fact, in order to meet high fixed costs, carriers in an overcapacity situation must increase rates in order to meet their costs with a decreasing load factor. The ideal situation for consumers is to have competition provide capacity that can fully meet demand. In this situation, the consumer receives the best service and the lowest rates. When capacity is in reasonable balance with demand, load factors are sufficiently high that individual rates can, in fact, be lowered. In contrast, in an overcapacity situation, because load factors are so low, carriers must raise rates dramatically to cover their costs. As I'm sure the Committee is aware, it is unlawful for a carrier to charge rates which are noncompensatory. Noncompensatory rates have always been considered by the courts as destructive competition. In an overcapacity situation where there is substantial excess capacity, ultimately the weaker carriers will fail, and the benefits of competition and the lower rates brought by competition are lost to the consumer.

6. Additionally, you say that losses from excessive overcapacity are a drain on subsidized companies in addition to unsubsidized companies. It seems that a good businessman would get out of a trade if that trade was draining him financially.

Why would this not be the case?

It does seem that a good business person would get out of a trade if that trade was draining the company financially. That is the way economics is suppose to work. However, when that good person has a subsidized company, good economics is distorted because as the courts have recognized and as Congress has recognized since 1936, a subsidized company has the additional benefit of subsidy and the staying power provided by that subsidy so it can afford to stay longer in a trade which is not profitable. Additionally, because the shipping business is characterized by extraordinarily high fixed costs in comparison to nonfixed costs, often times it may be determined that continuing to operate a ship unprofitably in an overcapacitized trade is economically preferable to taking the ship out of operation. Thus, a carrier may continue to operate excess capacity in an unprofitable trade because of the cash flow earned which does at least contribute to meeting fixed costs until and unless an alternative trade can be found that provides a better economic opportunity. Operating unprofitably at least provides better cash flow against fixed costs than terminating the vessel's operation. The ability to continue in an unprofitable or overcapacity trade is enhanced by the receipt of subsidy which provides additional staying power for the recipient.

SHB/788/AN8

Senator **Breaux**. Senator Inouye, any questions?

Senator **Inouye**. Yes.

Mr. Mulholland, I am certain you heard the question I asked the MARAD witness on the 1990 capacity. I have been advised that capacity will exceed cargo by about 19,000 FEU containers. Is that your understanding?

Mr. **Mulholland**. I am not familiar with that specific number, but that number sounds like a good number to me, 19,000. There is certainly surplus and excess capacity in the trade.

Senator **Inouye**. And I have been advised that if APL should get in that capacity would exceed cargo by nearly 50,000 FEU's.

Mr. **Mulholland**. That is correct.

Senator **Inouye**. And now, if we add five more ships that Sea-Land has said it will and double its capacity, how much more than 50 would we have?

Mr. **Mulholland**. I am assuming that at a minimum they would be bringing in the same capacity that APL is bringing, so that would bring the figure up by about at least another 30,000, I imagine.

Senator **Inouye**. How would that affect you, sir?

Mr. **Mulholland**. Well, I think the first thing that would happen is that when you bring that much capacity into the trade, you are going to destabilize the trade. That is, you are asking for wholesale rate wars. Anyone in the industry knows that no one could stand a rate war for a long period of time.

And the very first thing that starts to happen is that there is service deficiencies. In our case, we provide a lot of service. Our rates, as you know, Senator, are common fare rates, and that is that we charge the same amount of money to take a container to Nauwilli-willi or Kauihai or any of the neighbor islands as we do to Oahu. There is a certain cost involved there, and we would have to go back and re-evaluate that, under a rate instability situation, could we continue to afford to do that.

So the real losers in the short term are the carriers, because they no longer make a profit and they no longer can invest back into the industry. So the next tier of losers becomes the industry, because we are not going to buy any more ships in U.S. yards, we are not going to repair any more ships in U.S. yards.

And then the third and ultimate loser is usually the customer. Two things are going to happen. They are, generally speaking, going to be subject to wide fluctuations in rates; and they are going to get less service in the long haul.

Senator **Inouye**. Do you have any thoughts on the proposition made by Mr. Barer?

Mr. **Mulholland**. I agree with Stan that I think we have—if you were to look in the Alaska trade, the Puerto Rico trade, and the Hawaii trade, there is a common interest and a common opinion that these are domestic offshore trades and if they are adequately serviced by domestic carriers, Jones Act carriers, that is what the Act said to do and we have done a good job with that, and that we are commonly against the incursion of subsidized operators into the trade.

Relative to the affiliated service versus the mixed service, there it is just one of intensity. We are looking down the gun barrel at a mixed service problem, and that is APL runs a mixed service. That is what we are looking at. So we feel a little bit more concerned with the mixed service.

And we also feel that the spillover, application is—there is a greater chance of spillover when you are using the same ships that are being subsidized and, even more importantly, there is clearly a diversion of U.S.-flag capacity, and that is if you have got the same ship—and if you read APL's annual report, it says that their westbound capacity last year, 1989, was 94 percent utilization westbound.

Now, if they are going to take that capacity and divert it into the Hawaii trades, that is going to defer our need for additional capacity, so we will not be spending money in U.S. shipyards building ships, and the investment we already have there, which is significant, would be worth less. And it would also mean that they would not have as many slots available to carry the foreign commerce of this country.

And then when APL needs some additional, if they should need some additional capacity, where are they going to get it? They are going to get it like they have done in the past. They are going to look for windows of opportunity and they are going to build foreign.

So you have effectively cut off an avenue for Jones Act carriers to have any—the risk would be too great for them to continue to build ships in U.S. yards.

Senator INOUYE. As a Jones Act carrier and one who has relied upon the integrity of that law, how much have you spent in new ship construction and expansion in the past 10 years?

Mr. MULHOLLAND. Over the last decade, we have committed $550 million; in the last 5 years, slightly over $500 million if you run out through the year x1990. This is in a combination of vessels, vessel reconstructions—new construction, vessel reconstruction, and modifications, and also with container equipment and container handling equipment, $320 million of that has gone for vessel and vessel reconstruction. I have a list here, if you would like of our expenditures from 1986 running up through 1990, that I can submit for the record.

[The following information was subsequently received for the record:]

February 9, 1990
JEB:ra
Page 1 of 2

MATSON NAVIGATION COMPANY, INC.

PROPERTY ADDITIONS
1986/1990

	($000)
1986	
Vessels	
Construction two Neighbor Island barges	$20,324
Other vessel modifications	5,480
	25,804
Containers and related equipment	9,790
Cranes and lifting beams	3,733
Straddle carriers and yard tractors	250
Computer equipment and software	864
Other	1,400
	41,841
1987	
Vessels	
MATSONIA reconstruction	47,716
Other vessel modifications	1,389
	49,105
Containers and related equipment	28,874
Straddle carriers and yard tractors	5,534
Improvements to Terminals	1,305
Computer equipment and software	1,310
Other	2,192
	88,320
1988	
Vessels	
Barge Islander	9,394
Other vessel modifications	2,105
	11,499
Containers and related equipment	26,369
Cranes and lifting beams	1,716
Straddle carriers and yard tractors	9,185
Improvements to Terminals	941
Computer equipment and software	3,451
Other	1,034
	54,195

February 9, 1990
JEB:ra
Page 2 of 2

MATSON NAVIGATION COMPANY, INC.

PROPERTY ADDITIONS
1986/1990

	($000)
1989	
Vessels	
Purchase SS KAIMOKU	35,914
Other vessel modifications	970
	36,884
Containers and related equipment	19,515
Cranes and lifting beams	5,840
Straddle carriers and lifting beams	2,054
Computer equipment and software	18,762
Other (exclude MLC containers)	4,773
	87,828
1990 OPERATING PLAN	
Vessels	
New ship planned for 1992	167,000
Third Neighbor Island barge	10,000
Purchase and modification SS CAGUAS	38,000
Modification KAIMOKU	8,000
	223,000
Containers and related equipment	10,000
Cranes and lifting beams	26,000
Straddle carriers and yard tractor	5,000
Computer equipment and software	15,000
	279,000

RECAP
1986/1990

Vessels	$346,292
Containers and related equipment	94,548
Cranes and lifting beams	37,289
Straddle carriers and yard tractors	22,023
Improvements to Terminals	2,246
Computer equipment and software	39,387
Other	9,399
	$551,184

Senator Inouye. I think that would be very important because, as you have testified, without this type of amendment you may have not considered spending all that money. Is that correct?

Mr. Mulholland. That is true.

Senator Inouye. And is it your view that you would not object to the amendment, one standard for all?

Mr. Mulholland. I would not object to the one standard for all amendment, as long as it did not slow down the passage of 2170, because that is urgently needed. And if somehow this got wrapped up in ODS reform, then I would say let us treat the affiliated service—we have another opportunity to treat the affiliated service and that is when ODS reform comes up.

The mixed voyage issue is here now today, so in Matson's view I would say that would be of a little more critical importance, although I would say I agree with Mr. Barer that relative to subsidized operators in the domestic trade that they should pass an adequacy test.

Senator Inouye. You have stated that as a result of MarAd's method of calculating ODS, APL has received "an enormous amount of subsidy above that necessary to place APL on a par with its foreign competitors," and that this extra subsidy could result in unfair competition.

Are you suggesting that the method used by MarAd in calculating ODS is not permitted by the law?

Mr. Mulholland. No, I think that the method that MarAd uses to calculate is permitted by the law. But I am suggesting that it does not wash out all of the excess subsidy issues or subsidy spillover. It does not treat all of those issues. It is a rather long process.

If you would like, I could submit a written statement, a written response.

Senator Inouye. And how would that result in unfair competition?

Mr. Mulholland. Well, I think any time when the other guy starts with more money than you—in this case, if you go back and read their annual report, they started with $66 million last year worth of subsidy and we started with zero. And I think that any time you start off like that, and any portion of that money, whether it be one dollar, a million dollars, or $6 million, can trickle into the domestic trades, that that is unfair, and that it allows them a better cushion to withstand any rate wars that could come up in the future.

Senator Inouye. So what you are suggesting is a phrase that we are always using here: You are not on a level playing field.

Mr. Mulholland. We are not on a level playing field with the current administrative law judge's interpretation.

Senator Inouye. In the Pacific trade, would backhaul pricing give the CDS operator operator an advantage over a domestic mainland-Hawaii operator?

Mr. Mulholland. Backhaul pricing does give an advantage to the mixed operator in the Hawaii trade. Our head haul trade is from the West Coast, the United States West Coast, out to Hawaii, and that is where the vast majority of our cargo moves. Only about 25 to 30 percent of our containers coming back from Hawaii to the mainland are loaded containers. So we need to make a better recovery of our costs on the outbound leg.

On a mixed voyage, it is just the exact opposite. The head haul trade for a mixed voyage is coming back from Asia, where they pick up the $2,500 to $3,000 40-foot containerloads of electronic goods from Taiwan and bring them back in. So there they have a greater flexibility to reduce price on the outbound leg, which is our head haul trade.

So yes, it is an advantage for a mixed service operator over a dedicated turnaround operator like ourself.

Senator INOUYE. Thank you very much.

Senator BREAUX. Thank you, Senator. Thank you very much, Senator Inouye, for your questions.

We heard, Mr. Mulholland, how much you all expended last year in terms of ship construction and plant costs. How much have you made?

Mr. MULHOLLAND. You mean how much have we made last year?

Senator BREAUX. Yes.

Mr. MULHOLLAND. We made about $120 million gross operating profit.

Senator BREAUX. Senator Inouye mentioned, I think, that Sea-Land had announced a decision to move into that trade as an unsubsidized line. Would you interpret that decision by a carrier to move into a particular area as an indication of inadequacy of existing service?

Mr. MULHOLLAND. No, I would not.

Senator BREAUX. If not, why not? Why would a carrier that is unsubsidized move into a trade area if there was already adequate service?

Mr. MULHOLLAND. I really do not know all of the reasons why Sea-Land chose to do that.

Senator BREAUX. Probably to make money.

Mr. MULHOLLAND. Well, I am sure it was to make money. I think you still have to look at that Sea-Land is a mixed voyage operator, so they have other interests than Hawaii. They are going out to Guam, they are going out to Japan, they are going out to Taiwan. They have other interests which may not be solely in Hawaii.

So I would not see the additional capacity by Sea-Land as an indication that the Hawaii service was inadequate.

Senator BREAUX. What would an applicant have to prove in order to meet what you are suggesting as the new standard?

Mr. MULHOLLAND. Well, what I am suggesting or what I think Senator Inouye's bill is suggesting is that, first of all, we just sort of reaffirm what the guidelines and standards are.

Senator BREAUX. Well, we use the word "inadequacy" in this bill.

Mr. MULHOLLAND. Right.

Senator BREAUX. What do you interpret that that standard would require that an applicant would have to show?

Mr. MULHOLLAND. I think what it would have to show is both qualitative and quantitative measures, and that is that, firstly, is there enough capacity committed to the trade to take care of the trade? That is, can all the goods, customer goods and services, move in the time frame they want it to move in? That would be sort of a ballpark.

Then I think you could go down to a whole list of qualitative issues. In the case of the Hawaii trade, frequency is a qualitative issue. At the end of this year our annualized lift capacity will be 204 sailings a year. If you add the Sea-Land capacity in, their 100 sailings, that is 300 liner sailings a year to the Hawaii trade.

Then you have got to add in all the other domestic operators: almost a sailing a day. So relative to frequency, there is a lot of frequency.

Relative to the type of service, we have roll-on, roll-off service, we have lift-on service. We can take any size container, trailer, flatbed truck, tank trailer. You name it, there is a full range of service available to Hawaii.

Senator BREAUX. Suppose an applicant says, that is all true, but I can do it for 25 percent cheaper than they are doing it? Does that affect adequacy?

Mr. MULHOLLAND. The cheaper rates? Well, as long as the individual, as long as the company that was offering cheaper rates, did not have an unfair advantage, then our judgment would be that this is the marketplace and we can compete in it.

Bringing subsidized operators in with mixed voyages, that is not a level playing field.

Senator BREAUX. Are you dismissing the fact that they would have to repay the ODS and not have ODS on the ships that would be serving that area? Do you think that the system that says you cannot have those ODS subsidy payments overlap does not work or cannot be made to work?

Mr. MULHOLLAND. I do not see that as the major issue. The major issue in my mind is that, relative to the domestic offshore trades, if the existing unsubsidized carriers in those trades are providing adequate service, why is there a need to bring in a subsidized operator?

Senator BREAUX. Well, he does not come in as a subsidized operator, is the point I am trying to make. Do you think that the payback of the subsidy, which means that those ships calling on that domestic trade would in fact not be subsidized ships, is that something that you fundamentally think cannot be established, that these ships are not going to receive a subsidy going to Hawaii?

That is the law. Are you telling the committee that that is not possible to achieve, that situation, from a factual standpoint?

Mr. MULHOLLAND. I think under the present law, as well as I know it, and under the present conditions, that there has been some subsidy leakage, yes.

Senator BREAUX. Are there any particular cases you can bring to the attention of the committee? Because that is a very serious violation of the existing law. If there are subsidies being used in domestic routes under the law, that is illegal and that should be brought to the attention of the Congress to tighten up the law.

Mr. MULHOLLAND. The payback formula that MarAd is using, that is the law and that is what they are using. What I am saying is that, even though that is the law and that is what they are using, it still in itself does not provide a level playing field.

Senator BREAUX. What is different, then? What do they have after they do not have subsidy that you do not have?

Mr. Mulholland. Because they do not wash out every single dollar of it. They still are a subsidized operator. Subsidy moneys are fungible moneys, a dollar here and a dollar there. They still have a tremendous advantage. They are not looking at the same risk we are in this trade.

When we plop down our $500 million to invest in this trade, we do not have anyplace else to go with those ships. That is it. We are in a turnaround domestic service. We are dedicated to the Hawaii trade, and those ships cannot go out in foreign commerce, where APL or anybody else with a subsidy——

Senator Breaux. The point is that subsidies cannot be used in a domestic trade, even under a section 805 application that is found to be approved. There are specific sets of facts that have to be established in order to ensure that ODS subsidies do not leak over into the non-subsidized carriage to your area, to Hawaii.

And my point is, that is what the law says. Is the law not working? And then give me some examples of where it is not working, because they ought to be prosecuted or we ought to tighten up that provision.

Or are you saying it just cannot be written so that the ODS does not help out the carriage to that area? Because they should not be getting ODS leakage, direct payments, or any other kind of payments from the government to serve in a domestic trade. That is what the law says.

Now, if that is not working, we ought to change the law and tighten it up. But assuming that the law works, that operator is not getting anything more than you are getting in that area. Is that not correct, if the law works as it says?

If they do not get ODS on the ships that are carrying to a domestic port, what are the advantages, or if there are any advantages tell me what they are, that that company has?

Mr. Mulholland. Well, I think I can go back to the earlier comment, that they are still getting advantages of backhaul pricing. I mean, they are still a mixed voyage operator.

Senator Breaux. Which is something that you could also do if you wanted to carry to another port, too, and come back to Hawaii.

Mr. Mulholland. Well, if we wanted to go out——

Senator Breaux. It is not something that you would be prohibited from doing, either. It is not an advantage. It is something they do in the normal course of their business.

Mr. Mulholland. It is something they do. It still is an advantage. And as I say, we are a dedicated domestic——

Senator Breaux. That is not a government advantage. That is not something the government is giving them. That is something they decided to do on their own commercial investment.

They could make a faster ship. That would be an advantage. They could make a more fuel efficient ship. That would be an advantage. That is not a government advantage.

Mr. Mulholland. We would not have trouble if they made a faster ship or a more fuel efficient ship. I mean, those are the types of things we are used to competing with in the trade.

What we do not have is we do not have the backhaul pricing advantages like they do on their mixed voyages out to the Far East. They built those ships with CDS, they operate them with ODS.

Senator BREAUX. I do not know if we are talking in this situation about CDS ships. Are we?

Mr. MULHOLLAND. Yes.

Senator BREAUX. Not necessarily.

Mr. MULHOLLAND. Well, the APL application——

Senator BREAUX. I am not talking about the application that is pending over there. We are making a very conscious effort not to talk about it. We are changing a law that affects everything, not just one application down at MarAd. And I do not think the law is addressing just CDS-built ships. It says any ship, CDS or non-CDS.

Mr. MULHOLLAND. Right.

Mr. BARER. Mr. Chairman.

Senator BREAUX. I am going to get to you, Stan. Let me finish up with this one.

Do you interpret the bill, if it was adopted today or signed into law, to change the pending application that has currently been pending for three years before MarAd? Would it be effective on that pending application in your interpretation?

Mr. MULHOLLAND. If S. 2170 was to be enacted into law today, the APL application would come under that law, yes, and they would have to show adequacy, and if they could show adequacy then they could get in the trade.

Senator BREAUX. So do you interpret the legislation to put an adequacy test as the prime consideration in a section 805 application?

Mr. MULHOLLAND. Yes, we do. And to my knowledge there has never been an 805 application been granted if the trade shows that it is adequately serviced. I am not aware of any application where the trade was adequately serviced that a MarAd 805[a] application has been granted.

Senator BREAUX. Well then, you are telling me that the law as it currently is crafted is working? Is that not what you just said? You just said that an application for an 805 request has never been granted without a showing of inadequacy in the current situation in that route. That is what you just said, is it not?

Mr. MULHOLLAND. That is what I just said.

Senator BREAUX. Well then, the law is working.

Mr. MULHOLLAND. The law has been working and that is where we put our trust and faith.

Senator BREAUX. Then why change it?

Mr. MULHOLLAND. And that is where we put our $500 million.

Senator BREAUX. Why change it if it is working?

Mr. MULHOLLAND. Because there is an administrative law judge decision out today that says, even though the trade is adequately serviced, that APL or other subsidized carriers can still come into the Hawaii trade.

We sat in this room like you did and listened to the testimony from MarAd. It is very unclear what their own standards are. What we support in Senator Inouye's bill is the re-affirmation of what the standard should be. We have invested this money feeling that there is an adequacy test and if we pass an adequacy test that was sufficient.

Now all of a sudden there is an administrative law judge decision that has come out and says adequacy is not so important any more.

And what we are asking—you have gone from fundamental entitlement, you have gone from adequacy. Now you are going to another standard. The MarAd witness could not articulate what that standard is.

Well, how is it for us that have already invested the money? APL in this particular case—and I will just use their name—they have not invested a penny. What do they have at risk? There is nothing at risk. We are the ones that have the risk.

Senator **Breaux**. Senator Inouye.

Senator **Inouye**. Mr. Chairman, there is a vote going on and, regrettably, I have to leave this hearing, because we have the supplemental appropriations conference committee which is now going on.

If I may, Mr. Chairman, I would like to submit my questions to the other panelists.

Senator **Breaux**. Absolutely. Without objection, that will be done.

We have a roll call vote. The committee will be in recess just for the time to catch the vote and then return.

[Recess.]

Senator **Breaux**. The subcommittee will please come to order.

Mr. Barer, let me ask you a couple of questions. I know you have some comments you wanted to make. Would you explain for the committee the difference between a affiliated service and a mixed service? What constitutes each under your understanding?

Mr. **Barer**. Yes, sir. That difference is well illustrated in the difference between the service pattern, say, to Hawaii and the service pattern to Alaska. As Mr. Mulholland has explained, the situation in Hawaii is the subsidized carrier or potential subsidized carrier that would be in the trade would be stopping at Hawaii as part of a foreign voyage. So it is in mixed service, carrying partly foreign cargo and partly domestic cargo, domestic trade.

In Alaska, you do not have that mixed service. What you have is a turn-around service, a dedicated service between the lower 48 and Alaska, and that is an accident of world geography.

Senator **Breaux**. Is the mixed and affiliate service, does that not speak to the type of company structure as opposed to where the ships go?

Mr. **Barer**. Well, to both. For example, in Alaska carriers are currently—currently—non subsidized carriers. However, two of the three competitors, Sea-Land and Crowley, are also international traders. If they become subsidized, which is what the USA proposal is, then they wish to grandfather their existing Jones Act operations so they could continue to be Jones Act carriers and continue to be subsidized.

Senator **Breaux**. Would that be affiliated?

Mr. **Barer**. That would be called affiliated. And the problem that Congress recognized in 1936, and hopefully will still recognize, is that the real issue on subsidies is that if you write someone a check for $50 or $60 million a year on January 1 or whenever they get it, that company can take $50 or $60 million more economic risk, than can a non-subsidized carrier.

And what that means, even though that individual dollar may not go from this hand to this hand directly for expenses, for reimbursement of expenses in the Jones Act trade, if in fact the same companies get $60 or $60 million, that is $50 or $60 million more that they could use to buy ships, equipment, terminal facilities, pay executives, or bear lower rates of return in the domestic trade.

If you are making an extra $50 or $60 million internationally for doing exactly what you are doing today anyway, you can take more economic risk in the Jones Act trade.

Senator BREAUX. That is a cross-subsidization problem which we face in this committee in a number of areas: communications, telephone companies, et cetera, et cetera. Is there no way that that could be corrected legislatively to ensure that there is no cross-subsidization?

Mr. BARER. Well, one way is to say——

Senator BREAUX. Other than not allowing it?

Mr. BARER. I guess there is no way to make it for sure fixed. What you can do is make a tough, clear standard. I walked in here today reviewing my own testimony thinking, gee, there is something wrong, I cannot understand what the standard is under 805. After listening to the Maritime Administration witness, I feel much better at least about my own knowledge. He did not seem to know what it was, either.

And I think he was being absolutely honest. I do not think the Maritime Administration does know what the standard is, nor do I or anybody else.

And what we are saying is, if Congress is going to clarify that standard—and I think you should—clarify it for everybody. All the inadequacies that Senator Inouye pointed out about the current standard we would be left with under the current state of the legislation.

We believe what Senator Inouye said about the standard being inadequate, and if that is the case do not leave us there. Bring us along to the clear new standard. I would suggest, Senator, that even the USA proposal, which I do not support, which would subsidize our competitors in the Alaska trade, even that USA proposal ends up with a single standard under 805.

Senator BREAUX. What would be your interpretation of what would need to be shown in order to prove a case of inadequacy of service?

Mr. BARER. First of all, I think the burden of proof should be on the applicant, not the protestants to the application. And unfortunately, under recent cases there has been a burden-shifting where the Jones Act carriers must affirmatively prove that in the future there would be destructive competition driving them out of business. That is an impossible burden. I do not know how you prove that.

What I would hope the standard would be is, as Senator Inouye has suggested, but for everyone: put the burden of proof on the applicant to prove that there is inadequate service, in other words the ships and the frequency of service and the schedules do not serve the consumer adequately.

That is the real issue. That is what adequate service is. Now, I know that——

Senator BREAUX. Well, suppose an applicant comes in and says, I know you have got a lot of voyages and some of them are going and they are not full, so you have excess capacity. But I think I can provide better service, I think I can do it with faster ships, I think I can do it at a cheaper cost, even though there is more capacity out there right now than is needed for the cargo that is available.

Would you interpret that as meeting an adequacy test?

Mr. **Barer**. No, not necessarily, because we have seen, particularly in the Alaska trade—and I know this is true in the Hawaiian trade—a number of people who believed that and ended up going bankrupt.

Senator **Breaux**. Well, is adequacy, is the adequacy test met under your interpretation of how it should be carried out merely by a carrier who says, I have got more ships than I need, I do not have any competition out here, nobody else is servicing this area, but I have more ships than we have cargo for, therefore there is adequacy of service?

Mr. **Barer**. No. I think that part of adequacy should be competition. We believe in competition. In fact, we have more competition in Alaska than we know what to do with. We do have 50 percent excess capacity for the last year there.

But I think competition is good, and perhaps it is appropriate that there is a question of adequacy if there is not competition even if there are sufficient vessels.

But let me suggest this. It seems to me the real test of adequacy is whether a non-subsidized carrier, without the benefit of subsidy, will enter a trade and enter it successfully and sustain itself. I think any time you have subsidized carriers there is an extra incentive for them to leap in early, because they are able to take greater risks because of the subsidy.

Senator **Breaux**. Am I correct in stating the impression that I am getting from both of you that you believe it is impossible to construct a situation where a company that has both subsidized vessels non-subsidized vessels in that same company compete in the domestic trade without cross-subsidization occurring, and therefore the ODS somehow helping that non-subsidized carriage?

That is the crucial question.

Mr. **Barer**. Yes, sir. I do not think you are ever going to get rid of it completely. The question is whether you can keep it within boundaries that do not violate fairness and reasonableness.

You know, the situation that we look at, we have a competitor that is running almost 50 percent load factors last year, I think 52 percent load factor, and now wants to be subsidized. To us that is getting over the line of reasonableness, particularly when they have over 60 ships worldwide and they are the biggest Jones Act carrier in America.

You know, the point is the two of us sitting here are the only pure Jones Act carriers left.

Senator **Breaux**. Well, is that a correct statement of my interpretation of what I am hearing from you, is that it is impossible to construct a situation legislatively that would prevent the potential for cross-subsidization?

Mr. **Mulholland**. I think if you are receiving a government subsidy, there is always an opportunity for abuse, whether it be intentional or unintentional, whether it be leakage or slippage or whatever the phrase that the lawyers use. And that is why I think it is critically important to this hearing that the adequacy test be given a higher accountability in this proceeding, so that we do not have the opportunity of bringing in subsidized operators into the domestic offshore trades if the domestic offshore trade is in fact adequately serviced.

Senator Breaux. Other than capacity, what would you have them consider in making an adequacy determination?

Mr. Mulholland. I would think this could be done in a hearing process. But I think there's a whole range of quality——

Senator Breaux. I am not talking about how. What other factors would you consider in determining adequacy other than capacity?

Mr. Mulholland. I would think the range of ports served, that is how many ports are served by the existing capacity, and would the new entrant bring new extra ports? Would the new entrant bring any type of service that is not available? Would the new entrant or would the applicant bring some unique service quality that is not available to the trade?

I think there are a number of areas where you can go down and put a quality issue on and ask yourself, is this applicant bringing anything to the trade that the trade does not already have?

Senator Breaux. What about cost?

Mr. Mulholland. Well, we do not—from a cost standpoint—wait a minute. Could I have Mike?

Mr. Esch. Well, I think, if I could address that, in terms of costs I think that one operator is not going to be coming in with lower rates and all the other operators keep their higher rates. They are going to have to lower their rates to meet those lower rates, and the whole trade will experience rate instability and drive down the rates and the existing price.

Senator Breaux. I am not talking about the effect now of what would happen. Let me give you an example. Suppose the petitioner under section 805 comes in and says: The service in this area is inadequate because I can do it for half the price. Is that a legitimate consideration?

Mr. Esch. Well, when he says he is going to come in and do it at half the price, he is going to charge rates half the existing, going rates. Now, if he comes in and does that, he is going to have to have an effect on the existing operators, who are going to have to match his rates.

Senator Breaux. I do not think anyone is alleging that that is part of the test that has to be met, with regard to what others would do in relation to that.

If he could say—let us get a more reasonable situation here. Say in an 805 petition the guy says: The service is inadequate; it is inadequate because they charge too much. I can charge ten percent less and give the same type of quality of service.

Is that a condition, one of the factors in determining adequacy under your interpretation, or should it be?

Mr. Esch. I do not think so, because I think rates are a matter for Federal Maritime Commission regulation.

Mr. Mulholland. I agree, I do not think that is a consideration.

Senator Breaux. So the fact that a carrier can do it for cheaper should not be a consideration in an adequacy determination?

Mr. Esch. No.

Mr. **Mulholland**. No.

Senator **Breaux**. Okay.

Gentlemen, I appreciate it. Sorry about the timing. I think that you made a good presentation, and we may have some follow-up questions. I think Senator Inouye may, and I think Senator Lott as well has some questions that we will submit and ask you to respond.

Thank you very much.

Let me welcome the next panel, consisting of: Mr. Timothy Rhein, President of American President Lines (Domestic); Mr. Bill Verdon, President of United Shipowners of America; and John Stocker, President, Shipbuilders Council of America. Gentlemen, we welcome you. We are pleased to receive your testimony.

Mr. Rhein, we have you first, if you would go ahead. We are pleased to receive your testimony.

STATEMENT OF TIMOTHY J. RHEIN, PRESIDENT AND CHIEF OPERATING OFFICER, AMERICAN PRESIDENT DOMESTIC, INC., ACCOMPANIED BY DAVID V. AINSWORTH, VICE PRESIDENT AND GENERAL COUNSEL

Mr. **Rhein**. Thank you, Senator. With your indulgence, I would like to read my testimony. I promise you it will not be any more than four minutes in length, and I am a fast reader, so we will get through it pretty quickly.

My name is Tim Rhein. I have been associated with APL since 1967. For the record, I am no longer President of APL. Earlier this month I assumed a position as President of our domestic transportation company, American President Domestic, Incorporated.

We are the leading U.S.-flag container ship operator in the Pacific. As part of the American President Group, we offer point to point intermodal cargo transportation within and between North America and Asia.

It will come as no surprise that we are deeply concerned about this legislation and are opposed to its adoption. We strongly disagree with its substance. We worry that introduction and consideration of S. 2170 could interfere with the Maritime Administration's pending review of the administrative law judge's initial grant of authority under existing law for APL to serve Hawaii en route to the Far East.

We also are concerned that the bill could be perceived by MarAd as an attempt to overturn that decision. Let me explain. In February of 1987, more than three and a half years ago and millions of dollars ago, APL applied for approval under section 805(a) to serve Hawaii with vessels sailing from the Pacific coast en route to the Far East. This was certainly not the first application of an ODS operator to serve Hawaii. Indeed, many ODS operators have served Hawaii over the years and, as you know, the law recognizes ways for this to be done fairly.

APL has gone through almost two years of evidentiary trial-like hearings before a MarAd ALJ. In October of 1989, the ALJ issued a 176-page initial decision approving APL's application subject to certain conditions. APL cannot make more than weekly calls on Hawaii, can serve Hawaii only from California and not the Pacific

Northwest, and we are restricted in the level of cargo we can carry, and we are subject to a five-year review of the grant of authority.

This approval is currently on appeal at the Maritime Administration. APL continues to await the agency's final decision, some three and a half years after our initial application.

I want to note that, while we greatly appreciate the opportunity to testify here, we are severely constrained in what we can say. I am sure the committee understands that we cannot say anything today that in any way could be used by others to argue that the ongoing administrative process has somehow been tainted and was not fair, objective, or free from the influence of external forces, including Congressional influence.

We trust that the Maritime Administration will stick to reviewing the record and will make its decision solely on the merits and pursuant to the existing legal standards.

Accordingly, even if I were qualified to do so, I do not believe it appropriate to undertake a detailed debate of what the ALJ did or did not find with respect to the law and facts in his 176-page decision that followed the two-year hearing on APL's application.

That decision speaks for itself and I submit it for the record.

With these caveats in mind, however, I would like to briefly discuss the changes proposed by S. 2170 to the current standards governing the extent to which operating-differential subsidy contractors may be permitted to serve the domestic trades.

805(a) requires MarAd approval before an ODS contractor or any of its corporate affiliates may engage in domestic ocean service. As anyone who has gone through the approval process can verify, it is extremely arduous. Historically, it has not resulted in carte blanche authority being given to the ODS operator.

Section 805(a) establishes two criteria for judging an application: first, an application will be denied if it is found that the proposed service will result in unfair competition to an exclusive domestic operator in the domestic trade. "Unfair competition" has been interpreted to mean the existence of a substantial competitive advantage in the domestic trade from residual ODS.

Under 605(a) of the 1936 Act, ODS is reduced pro rata for any domestic ocean service performed by an ODS contractor. In essence, therefore, the unfair competition issue turns on the questions of whether the applicant can be found to receive a residual benefit from ODS after the section 605(a) reduction and, if so, whether the residual benefit will provide a substantial advantage.

Second, an application will be denied if the proposed service would be prejudicial to the objects and policy of the 1936 Act. "Objects and policy" addresses all interests in an affected trade, including not only those of the carriers, but of shippers and consumers as well.

In addition, section 805(a) provides that an ODS contractor may not divert ODS from foreign trade operations into the domestic trades and provides sanctions against doing so.

S. 2170 would radically revise current law to make it much more difficult for ODS carriers to provide domestic service. The bill seeks to resurrect from a very old grave the anti-competitive, anti-consumer, anti-trade fundamental entitlement doctrine. Under this doctrine, domestic operators in a trade were "fundamentally entitled" to all the cargo they had the capacity to carry, free of any competition from an ODS contractor.

More than 30 years ago, the Federal courts rejected this idea under section 805(a) as anti-competitive and inconsistent with the purposes of the Merchant Marine Act, which are broader than just the protection of existing operators from competition.

Yet S. 2170 would establish just such a standard and make adequacy the exclusive factor in determining whether to approve an application by an ODS contractor. Under section 805(a), adequacy always has been one of the factors considered, but not the only one.

Specifically, under S. 2170 an ODS contractor would be permitted to serve a domestic trade in mixed service only if it is found that the existing service provided by all vessels is inadequate. We believe this standard rejects the principle and recognized benefits of competition and the broader purposes of the 1936 Act.

In addition, the bill would require the proposed mixed domestic service or affiliated domestic service must not be supported, directly or indirectly, by any money paid to the applicant under the ODS provisions of the 1936 Act. The meaning of this is unclear and it might be viewed as an attempt to legislate into law the argument that any funds or assets that are in any way connected with subsidized service cannot be used in the domestic service.

This argument is regularly advanced by domestic operators in section 805 proceedings and it is just as regularly rejected.

Simply put, we believe the effect of these changes would be that solely domestic operators, already protected from foreign competition, would be shielded from competition by other U.S.-flag operators as well. We fail to understand how establishing such a monopoly would serve the interest of consumers and shippers who rely almost totally on waterborne transportation in the domestic trades.

Congress did not intend to grant domestic operators such protection in 1936. Indeed, proposals to prohibit ODS contractors from serving the domestic trades were explicitly rejected. Instead, Congress balanced the interests of the various carriers and users and consumers of shipping services and set forth standards to be applied in evaluating whether domestic service by ODS contractors should be permitted. Moreover, Congress grandfathered all existing services by ODS contractors.

Given the trend toward deregulation and increased competition in our national transportation policy, the position adopted in 1936 is even more appropriate today.

Mr. Chairman, just focusing for a moment on the Hawaii trade, the judge who heard the witnesses and immersed himself in the massive record of the proceeding on our pending application found that APL's entry would not overtonnage the trade, but rather would leave it with "a comfortable margin of supply over demand" that would suit the shippers' needs. He found APL's entry would result in benefit to the shipping public by providing a valuable and flexible container carrier alternative.

The judge also found that APL's entry would not result in unfair competition to existing operators or unduly impact them.

Frankly, we find it hard to understand how additional competition would affect the continued viability of the domestic carrier serving Hawaii, Matson. Their operating profit last year by Mr.

Mulholland's testimony was $124 million. Its operating profits have averaged $110 million over the last five years.

Matson enjoys an enviable 24 percent ratio of operating profit to gross revenue. As the ALJ found, Matson is the most profitable operator of liner vessels under U.S.-flag and has indicated that it expects to continue to operate profitably even if APL's application is granted.

Even with APL carrying the entire amount of cargo authorized in the initial decision, Matson itself has acknowledged that it will continue to carry substantially in excess of 50 percent of the cargo in the Hawaii market.

Finally, Mr. Chairman, I must add that I completely agree with Mr. Verdon's written statement, which he will testify to in just a moment, that any prospective changes to 805(a) should only be considered as part of a broader ODS reform bill.

We are a founding member of the United Shipowners of America and no company has worked harder to achieve a fair, comprehensive reform of the ODS program. As Mr. Verdon will explain USA members have reached agreement on such a proposal. We have been working with the Administration, the unions and the domestic operators to attempt to resolve or at least narrow our differences.

We sincerely hope that this committee will hold hearings on ODS reform in the very near future as the first step towards enactment of ODS reform legislation this year.

Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

QUESTION 1:

Q: The ODS contract between the USA and APL (Contract No. MA/MSB-417) contains the following proviso:

> **Provided that, no subsidy accrued hereunder otherwise allowable under the Act shall be paid unless and until the Operator has requested and has been granted such waivers or permission as may be required pursuant to this Agreement or the Act, or subsequent legislation having the same or substantially similar force and effect, or other applicable provisions of law as determined by the United States.**

At this point, of course, APL does not have permission to serve Hawaii. MarAd is not bound to follow the recommendation of the Administrative Law Judge; and even if it does petition for agency reconsideration and judicial appeals will inevitably follow.

But assuming APL does get Section 805 permission, and afterwards S. 2170 is enacted. Now under S. 2170, MarAd would have 180 days after enactment to determine if APL's Mainland-Hawaii service is in accordance with S. 2170. If not, MarAd would have to bring APL into compliance.

My question is: By virtue of the language in APL's ODS contract which I just read, hasn't APL already agreed to accept S. 2170, if it becomes law? So where is the inequity in S. 2170?

A: No. We do not believe that S. 2170 can be considered to have the same force and effect as existing law. In fact, S. 2170 would radically revise current law to make it much more difficult for an ODS contractor to serve domestic trades. As we testified, it appears to us that the purpose of the bill is to keep APL from serving Hawaii. We fail to see how enactment of such anti-shipper, anti-consumer, anti-competition legislation is in the public interest.

Question 2:

Q: (a) Assuming S. 2170 had been enacted before you applied for Section 805 permission to serve Hawaii. Would you still have sought that permission, and if not, why?

(b) If you would have still applied for Section 805 permission, at the ensuing hearing what additional facts or arguments would you have advanced? Although adequacy of service is a factor in Section 805 applications, APL agreed not to put on any shipper interests from Hawaii at the hearing. In effect, agreeing that service from the Mainland to Hawaii is adequate.

In this respect the facts on this most critical issue are just the opposite of what they were in the last "mixed service" application before MarAd - Delta S.S. Lines, Inc. (1970). In Delta the Hearing Examiner said:

> **[T]he preponderance of the evidence compels a finding that the existing service between the Gulf and Puerto Rico is inadequate - causing inconvenience to shippers, higher transportation costs, diversion of shipments to other ports, and a failure of the Gulf area to capitalize on its natural advantage of lower inbound transportation rates.**

So I ask, what would APL have done in the case that it didn't do, if S. 2170 had been law?

A: It is not possible to speculate, three years after the operative events, as to the institutional approach that APL might have taken with respect to its application to serve Hawaii, and the prosecution of that application, had S. 2170 been law at the time.

However, we do believe it necessary to identify a serious misconception in this question: The decision to exclude shipper testimony had nothing whatever to do with the issue of adequacy of service in the trade. To the contrary, as explained by the ALJ in the Initial Decision [p. 6].

> "By agreement of the parties, no shipper witness testimony was presented, pursuant to a prehearing stipulation that shippers' testimony presented on behalf of APL and the intervenors would be likely to cancel each other out."

(continuation of Question 2 answer)

Moreover, we believe the assumption implicit in the question -- that service to Hawaii has been and will be adequate -- to be wrong. This is evidenced both by the Administrative Law Judge's Initial Decision finding that in the trade to Hawaii "the relationship of demand to capacity will be tight within the time frame of the 1990's" [p. 133] and the actions of both Matson and Sea-Land which have added, or announced an intention to add, capacity to the trade since the Docket S-801 record has closed in an effort to keep up with the growing demand.

Question 3:

Q: Adequacy of service-quantitative and qualitative-is, of course, a key test under S. 2170.

When do you consider service in a domestic trade adequate?

A: We do not believe such an issue can be decided in the abstract but must be considered with respect to a specific trade or trades.

In the case of APL's application to serve Hawaii, we would note that the ALJ found that a calculation that simply matches supply and demand on an annual basis would indicate marginally sufficient vessel space; but that it is necessary to take into account additional factors such as seasonality, difficulties in matching supply and demand, and errors in supply/demand assumptions. Taking all these into account the ALJ found that without APL's service "the relationship of demand to capacity will be tight within the time frame of the 1990s..." Moreover, the ALJ stated: "nor can it be concluded that the availability of APL's 28,200 FEUs would severely overtonnage the trade as intervenors contend. Rather, this would leave the west bound Hawaii trade with a comfortable margin of supply over demand that would suit the shippers' needs, particularly where the shippers would be given a new alternative and flexibility for shipment of their goods by having an additional competitor such as APL in the trade." [Initial Decision pp. 133-134]

Question 4:

Q: In your letter of August 17, 1989 to the Maritime Subsidy Board applying for amended service descriptions and increased service, APL states that "there can be no dispute that U.S.-flag participation is inadequate on Trade Route 2, and in trans-Pacific trade more generally." I believe MARAD has not yet acted on that application, and on April 27, 1990, APL asked MARAD for "expeditious action".

- **Notwithstanding your application for increased service to the Far East, and your recognition that U.S.-flag service is inadequate in that trade, hasn't APL entered into a service reduction agreement with foreign-flag carriers in that trade?[1]**
- **Why would APL enter into a service reduction agreement with its competitors and then request MARAD to expedite its application to increase service?**
- **If U.S.-flag service is inadequate, wouldn't it become even more so if APL gets Section 805 permission to carry cargo between the Mainland and Hawaii?**

A: APL has not entered into a service reduction agreement. Rather, it has entered into an agreement with the principal trans-Pacific operators to restrain excess capacity in the trade that began to be experienced in 1988. Any resulting reduction in capacity is temporary in nature and is subject to upward adjustment to meet increases in demand.

The issue of the possible impact of service of Hawaii on APL's foreign commerce service was litigated in Docket S-801. There the ALJ found, among other considerations of relevance to the issue, that "there will be no material detraction of the APL resources from the foreign commerce to the domestic service * * *" [p. 164]

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[1] Although the service reduction agreement only applies eastbound, at the time APL entered into the agreement it also replaced larger vessels with smaller ones in the Pacific Northwest-Far East trade. Thus reducing its capacity not only eastbound but westbound.

Question 5:

Q: Suppose APL ultimately does not receive Section 805 permission.

Under USA's ODS reform proposal, you will still be legislated into the Mainland-Hawaii trade, even if there is prejudice to the objects and policy of the Act, or unfair competition to a domestic operator.

How is this consistent with our national Maritime policy?

A: APL remains confident that its application to serve Hawaii will be approved. We trust that the Maritime Administration's decision will be based solely on its review of the record and on the merits pursuant to the existing legal standards.

Section 805 is related to ODS reform because all such proposals would extend the program to currently unsubsidized operators which presently have domestic operations. Thus, ODS reform legislation has had to address whether, and in what way, the domestic services of such operators should be permitted. Some members of USA (Sea-Land; Crowley) have insisted that such operations be grandfathered. In turn, as a matter of fairness and a "level playing field," we believe that pending requests by ODS carriers to serve the domestic trades should also be granted by the legislation.

Question 6:

Q: With respect to formal, on-the-record agency hearings, I believe it is 'horn book' law that:

- **Nothing may be treated as evidence that has not been introduced as such and what is said at this hearing is, therefore, not evidence.**
- **An agency's decision must be based on the record taken as a whole.**
- **There is a presumption of regularity with respect to the agency's decision.**

MARAD has testified that APL's contested Section 805 hearing was a formal, trial-type hearing in accordance with the Administrative Procedure Act.

(a) Why, therefore, the concern you express on p.3 that the administrative process may be subverted by this hearing or S. 2170?

(b) Is it your contention that Congress does not have the Constitutional authority to enact a retrospective law? If so, I respectfully submit you are in error. We may do so as long as the law is a valid exercise of our legislative powers, and does not violate the "taking clause" with respect to the 5th Amendment's due process protection of property.

A: Chairman Breaux noted in his opening statement that the Committee and Congress must be careful not to intrude on the integrity of the on-going proceeding (APL's pending application) at Marad. Moreover, as Senator Inouye recognized in his opening statement, it is possible that the bill and/or the hearing could result in improper Congressional interference with an administrative proceeding (noting Pillsbury v. FTC). As we testified, we are concerned that the introduction and consideration of S. 2170 could interfere with Marad's pending review of the ALJ's initial grant of authority under existing law for APL to serve Hawaii. We also are concerned that the bill could be perceived by Marad as an attempt to overturn that decision.

We recognize and appreciate Congress' constitutional authority to legislate. We note, however, that Congress usually passes laws of general application and prospective effect. Moreover, we believe there are constitutional and contractual limitations on Congress' ability to pass more narrowly focused, targeted, retroactive legislation. In this regard, we believe the testimony of Matson Navigation Company leaves little doubt that the impetus for S. 2170 was the ALJ's decision granting APL permission to serve Hawaii. ("We are looking down the gun barrel at a mixed service application, and that is APL runs a mixed service.")

Question 7:

Q: According to statistics, I have seen for the five-year period 1985-1989, APL's operating financial picture was as follows:

	Gross Revenue	ODS	Income Before Taxes With ODS	Income Before Taxes Without ODS
1985	$1.7 (billion)	$64 (million)	$48 (million)	-$16 (million)
1986	1.4	66	27	- 39
1987	1.8	66	140	+ 74
1988	2.0	63	98	+ 35
1989	2.2	66	8	- 58

So APL had a pre-tax loss in three of those five years.

It is fair to say, I think, that without ODS, it would be very difficult for APL to operate under the U.S.-flag; and you also receive another form of subsidy to make your operation possible, i.e., reservation of military cargo for U.S.-flags.

APL's ability to operate is therefore directly due to these two forms of subsidy to operate in our essential foreign trades.

And the fact that you would forego ODS for the Mainland-Hawaii portion of a mixed voyage does not alter the fact that you would not be in a position to carry domestic cargo, if it were not for ODS.

Assuming there is no compelling shipper or public need, why should you be able to use the fact of ODS to enable you to compete with an unsubsidized domestic carrier?

A: We are being asked the wrong question based on wrong information.

To begin with, the financial data presented is completely erroneous: it is not accurate for APL or even APC (the parent company).

Putting that aside, we believe there is a compelling shipper and public need for our service. On that score, we have received extensive indications of shippers support for our proposed service. We would not have spent three years and several million dollars trying to obtain government approval to serve the Hawaii trade if we did not firmly believe that such service was economically justified in the market.

Moreover, as the testimony and answers to the questions at the hearing confirmed and emphasized, our Hawaiian service cannot and would not be subsidized.

Finally, we think the more appropriate question should be: why should Congress shield domestic operators from fair competition by other Jones Act carriers?!

Question 8:

Q: If you receive Section 805 permission, what percentage of your westbound domestic cargo will move under tariffs filed at the ICC; the FMC?

A: The answer will depend on several factors and is under continuing evaluation by the company. However, APL assures the Committee that it will file all tariffs as required at the ICC or FMC.

Question 9:

Q: Some have said that the "adequacy" test in S.2170 is the functional equivalent of the "fundamental entitlement" doctrine which was rejected by the Secretary and the Courts in the States Steamship case, which is, I believe, considered to be the landmark "mixed service" case.

Others, including myself, disagree, and maintain there is no equivalence between the "adequacy test" in S. 2170, and the doctrine that a domestic carrier has a fundamental right vis-a-vis a subsidized carrier to carry all the cargo it has capacity to carry.

In States Steamship the Secretary found:

- **That Matson carried and would continue to carry 95% of the cargo between the Mainland and Hawaii.**
- **Service in that trade was inadequate; and therefore grant of States application would not overtonnage the trade.**

On those findings the Secretary determined that grant of States Section 805 application would not be prejudicial to the objects and policy of the Act because overtonnaging and its adverse effects would not occur since service was inadequate. Therefore, for the Secretary to have determined otherwise on the basis of those findings he would have had to conclude that Matson had a right to carry all of the cargo it had the capacity to carry. That would have been "fundamental entitlement."

(a) Do you agree that given the findings of inadequate service in States, the Secretary could have reached the result he did even if S. 2170 had been the law?

(b) Suppose, however, in the States case the Secretary had found that service in the trade was adequate, and he concluded that the trade would be overtonnaged if States Section 805 application were granted. The increased presence of States would therefore create the real possibility of creating a vastly different and adverse impact on the Mainland-Hawaii trade.

If the Secretary were to deny States application under those circumstances, he would be doing so not because Matson was "fundamentally entitled" to carry all the cargo it had the capacity for, but because to grant the application would be prejudicial to the objects and policy of the Act. Isn't this what S. 2170 is all about?

A: The meaning, significance, and effect of the States decision was extensively debated in the pending proceeding before Marad. We do not believe it is appropriate to reargue such issues at this time or to engage in hypothetical speculation. We would note, however, the ALJ's finding regarding inadequacy of capacity in the Hawaii trade (see our previous answer).

Question 10:

Q: Should a shortfall in capacity in a domestic trade, due mainly to short-term factors (the Hawaii-Maine Lines Strike; the bankruptcy of United States Lines), be considered in determining whether service is inadequate under S. 2170?

A: First, we believe the cited factors are long term not short-term -- we note that Hawaii-Maine Lines has now withdrawn from the trade and U.S. Lines is no longer operating.

Second, we believe that all factors that could affect capacity in a trade should be considered under Section 805. We believe existing law does a better job of taking into account all factors and equities.

Question 11:

Q: Under S. 3270, all applications of common carriers for Section 805 permission would be required to "disclose the nature and scope of operations proposed to be conducted in coastwise or intercostal trade".

In Aeron Marine, I believe the Secretary of DOT held that an applicant need not specify its proposed operations.

Would you please give the Subcommittee your views on the "pros" and "cons" of the provision in S. 2170?

A: With respect to APL's application to serve Hawaii, the company could not have been more precise about its proposed operations. As to whether Section 805 should be amended to so require, we simply note that in 1987, as part of a broader ODS reform proposal, APL, Sea-Land and Lykes agreed with Matson and TOTEM on prospective changes to Section 805 that so provided.

Question 12:

Q: The reason why liner operators receive ODS is to put them on an operating parity with their foreign-flag competitors in our international trade. In fact, the Act provides that ODS will not be paid for additional U.S.-flag service in a trade, unless the existing U.S.-flag service is inadequate.

Section 805 permission, on the other hand, is concerned with our domestic trades, and the effect of competition in them between subsidized and unsubsidized U.S.-flag carriers.

Why therefore should a Section 805 issue be considered part of ODS reform, which is intended to put U.S.-flags on operating parity with their competitors in our foreign trades?

A: Section 805 is related to ODS reform because all such proposals would extend the program to currently unsubsidized operators which presently have domestic operations. Thus, ODS reform legislation has had to address whether, and in what way, the domestic services of such operators should be permitted. Some members of USA (Sea-Land; Crowley) have insisted that such operations be grandfathered. In turn, as a matter of fairness and a "level playing field," we believe that pending requests by ODS carriers to serve the domestic trades should also be granted by the legislation.

Question 13:

Q: (a) What is "back-haul" pricing?
(b) In the trans-Pacific trades, would "back-haul" pricing give a mixed service operator an advantage over a domestic, Mainland-Hawaii operator?

A: We don't know; it appears to be a concept invented in order to argue that certain carriers have, by virtue of their particular deployment and operation, some allegedly unfair advantage. In the Trans-Pacific trades, there is no "backhaul" in services or prices. We offer and price our services at competitive levels wherever we go.

Question 14:

1. APL receives operating subsidy (ODS) on both its line-haul vessels and its connecting "feeder" vessels. If APL operates in the domestic trade under Section 605(a), its ODS must be reduced by the ratio of domestic commerce revenues to total voyage revenues.

> **(a) In the past, has APL included, in the total voyage revenues of the line-haul vessel for purposes of the Section 605(a) ODS reduction formula, revenues for foreign commerce cargo that is carried on both its line-haul and feeder vessels on a through bill of lading?**
>
> **(b) If APL includes the revenues attributable, in part, to carriage of cargo on feeder vessels, but excludes any feeder vessel ODS from the subsidy reduction calculation, does that not distort the subsidy reduction mandated by Section 605(a)?**

2. APL's annual report states that its 1989 trans-Pacific vessel utilization was 93% westbound from the U.S. (slightly higher than the 92% eastbound to the U.S.)

Will APL have to divert capacity from carrying foreign commerce cargo, for which it is paid subsidy, in order to carry domestic cargo to Hawaii?

A: Question (1)

APL's ODS is reduced pursuant to Section 605(a) for revenue earned in serving Guam. All calculations of APL's Section 605(a) subsidy reductions have been reviewed by Marad. In Docket S-801 Matson argued that the calculations were distorted. The ALJ found that "the validity of these claims is questionable" but that even assuming for argument purposes that Matson was correct, the issue is of "de minimis" significance. [Initial Decision p. 79]"

Question (2)

The utilization reported in APC's 1989 annual report does not reflect the full capacity of the APL fleet in the fleet configuration that would be utilized in serving Hawaii. As I noted in responding to Question 4, the impact of serving Hawaii on APL's foreign commerce service was litigated in Docket S-801, where the ALJ found, among other considerations of relevance to the issue, that "there will be no material detraction of the APL resources from the foreign commerce to the domestic service." [p. 164]

Question 14:

(third part of question)

Q: The Initial Decision in MarAd Docket S-801 states that APL's own analysis of the Hawaii service for which it has requested Section 805(a) permission would provide APL an annual rate of return on capital of 91%, so that APL would recover all of its capital investment after one year and three months of operation. The decision further states that APL would have a substantial cost advantage over dedicated domestic operators because of APL's backhaul pricing advantage. If APL enters the Hawaii trade, will it match the predominant rate structure, or offer lower rates in order to pass the savings on to its customers?

A: In the case of Hawaii, it is reasonable to expect that the addition of a third carrier to the trade will act as a restraint on rates. Certainly a monopoly carrier, such as Matson, has no such discipline or restraint. Matson carries 75% of the containerized freight moving westward to Hawaii and 100% of the east bound cargo. Matson has initiated 21 rate increases at the FMC in the last 13 years. Matson has filed two rate increases in the past two years alone.

The State of Hawaii Attorney General's office has opposed Matson's recent increase, which is being investigated by the FMC. I have previously submitted excerpts from the State's filing of March 10, 1990. The Attorney General notes that "the combination of Matson's service quality, service reliability, and market share allows Matson to dictate price in the trade." Moreover, "Matson has supported its rate request, in part, with investment not needed for service requirements but designed to ward off actual and potential competition."

Question 15:

Q: As I understand it, USA's ODS reform proposal would amend Section 605(a) of the Merchant Marine Act which provides a formula for abating ODS when an ODS operator engages in a mixed foreign and domestic voyage.

If the present formula provides adequate protection for domestic operators against unfair competition as you have testified, why does USA propose to change it?

A: First, we believe existing law is fully adequate to ensure that ODS contractors are not subsidized for providing domestic transportation. Marad administers ODS on a per ship basis and determines the payback based on the statutory formula.

The shift to a per diem formula in the USA bill was intended to eliminate the argument that sailings to Hawaii by subsidized vessels are in any possible respect supported by subsidy during the Hawaii leg of the voyage.

QUESTIONS OF SENATOR BREAUX AND THE ANSWERS OF MR. RHEIN

Q-1. Why do you believe you should be able to engage in domestic trade while you receive subsidy?

- **How can you assure that there is no residual benefit to your domestic operations that is derived from your subsidized operation?**
- **What Federal agency is responsible for maintaining your operation to ensure that there is no residual benefit?**
- **If you are permitted to operate in the Hawaii trade would your rates be regulated by the FMC or the ICC?**

A: To begin with, under existing law we do not receive subsidy for the domestic portion of a mixed foreign/domestic voyage. Section 605(a) provides that any subsidy we receive must be reduced based on the percentage of gross revenue derived from the domestic transportation. Thus, to be clear, we are not subsidized for providing domestic transportation.

Second, ODS is provided to APL in an attempt to equalize the cost of using American and foreign crews in APL's foreign trade operations. In fact, there is no "benefit" to APL: ODS is intended simply to cover APL's higher costs of operating the vessel. Every dime of the subsidy we get is used exclusively for that purpose. Moreover, it has been our experience that payments fail even to make up for all the higher costs of operating under U.S.-flag. Thus, there is not even something theoretical to "leak". As Senator Breaux aptly summarized: there is no cross-subsidization possible because there is no money left.

Third, ODS is administered on a per ship basis and the payback formula is determined by the Maritime Administration, DOT pursuant to statute. It is not APL's determination as to what the company should receive; it is the government's.

Fourth, the question of any "residual benefit" to APL's service to Hawaii was extensively argued and considered in the administrative proceeding. In this regard, I simply would like to point out that:

- Matson conceded that all of our subsidy payments were legal and calculated strictly in accordance with the statute and Marad regulations;
- The ALJ found that even if he were to accept Matson's claim that a residual subsidy benefit existed (which he did not): (1) the amount was de minimus; (2) the amount did not disadvantage Matson vis-a-vis APL; and (3) Matson's "position in the trade, its greater frequency and flexibility of its operations, the financial and regulatory restrictions on entry of the trade, the reduced importance of ODS to APL, and Matson's substantial benefit from its [capital construction fund], constitute on the aggregate, factors that far outweigh any competitive advantage that APL might secure" from the alleged subsidy benefits. [Initial Decision, p. 87]

Finally, if APL serves Hawaii, its rates would be subject to the jurisdiction of the FMC and/or ICC.

Q-2. How do you address the argument that you will have more "staying power" in the domestic trade than unsubsidized operators and that you can take more risk in domestic operations because of the subsidy you receive in foreign operations?

A: In terms of "staying power" it is important to keep in mind that ODS is provided to APL in an attempt to equalize the cost of using American and foreign crews. 100 percent of the subsidy is a pass-through in terms of equalizing crew wages. It is intended to let us start at the same place when we face foreign carriers. (Indeed, because we are saddled with capital cost and regulatory disadvantages, we really do not even get to start at the same place. That's one reason we need ODS reform.)

To put it another way, ODS helps us take on the risk of foreign competition. All of our ODS is used for that purpose. There is nothing left to use for other purposes. At the same time, as we all know, the Jones' Act trades are completely insulated from foreign competition. In that sense, there is much less risk -- most particularly in the Hawaii trade where only two container operators compete and one carries over 70% of the market.

APL's profit last year was $11 million on gross sales of well over $2 billion. If you are looking for staying power look to the domestic trade. Matson last year made $124 million on $400 million in revenues. Its operating profits have averaged $110 million over the last five years. Matson enjoys an enviable 24% ratio of operating profit to gross revenue. As the ALJ found, "Matson is the most profitable operator of liner vessels under U.S.-flag" and "has indicated that it expects to continue to operate profitably even if APL's application is granted." [Initial Decision pages 152-3] Even with APL carrying the entire amount of cargo authorized in the ALJ's Initial Decision, Matson itself has acknowledged that it will continue to carry substantially in excess of 50% of the cargo in the Hawaiian market. Now that's what I call staying power!

Q-3. Do you believe the addition of other carriers into the domestic trades, especially subsidized carriers would affect shipping rates? If so, in what way.

A: First, as we have pointed out at length, the question of whether a carrier is or is not subsidized with respect to its foreign operations is irrelevant with respect to servicing the domestic trades, since any ODS contractor does not receive subsidy when serving the domestic trades.

Second, in the case of Hawaii, it is reasonable to expect that the addition of a third carrier to the trade will act as a restraint on rates. Certainly a monopoly carrier, such as Matson, has no such discipline or restraint. Matson carries 75% of the containerized freight moving westward to Hawaii and 100% of the east bound cargo. Matson has initiated 21 rate increases at the FMC in the last 13 years. Matson has filed two rate increases in the past two years alone.

The State of Hawaii Attorney General's office has opposed Matson's most recent increase, which is being investigated by the FMC. Attached to my answer are excerpts from the State's filing of March 10, 1990[1] The Attorney General notes that "the combination of Matson's service quality, service reliability, and market share allows Matson to dictate price in the trade." Moreover, "Matson has supported its rate request, in part, with investment not needed for service requirements but designed to ward off actual and potential competition."

1/ The attachments submitted were not reproducible.

Q-4. Do you have any indication from shippers what their views are on unsubsidized carriers operating in the domestic trades?

A: We believe that shippers neither know nor care whether a carrier is an ODS contractor. What they care about, what they are interested in, is service and competition.

On that score, we have received extensive indications of shippers support for our proposed service. Believe me, we would not have spent three years and several million dollars trying to obtain government approval to serve that trade if we did not firmly believe that such service was economically justified in the market.

In this regard, attached to my answer is an article from the April 30, 1990, Pacific Business News, quoting several shippers who would like to see our service begin.

Q-5. How do you address the concern that allowing subsidized operators into the domestic trades will result in an overcapacity in those trades?

- **Do you believe that the increase in capacity by Sea-Land in the west coast to Hawaii trade with the addition of 2 more ships will result in an overcapacity in that trade?**

A: The argument about "overcapacity" is advanced by domestic carriers who claim that they are "fundamentally entitled" to carry all the cargo they can -- even if shippers want alternatives and want competition. Indeed, the existing Hawaii carriers claim that when the trade needs more capacity they are entitled to add more capacity to the exclusion of a new competitor, such as APL. But that is not the law, and should not be the law.

Moreover, capacity as such is not a meaningful measure of the conditions in a trade. Insofar as there may be a legitimate concern that the amount of tonnage in a trade will be so far in excess of demand as to possibly lead to wholesale rate wars and operators subsequently leaving the trade with attendant disruption, this is already addressed under the existing Section 805(a) when a decision is made as to whether an ODS contractor's proposed domestic service would be prejudicial to the objects and polices of the Act.

As to Hawaii, the ALJ found that a calculation that simply matches supply and demand on an annual basis would indicate marginally sufficient vessel space; but that it is necessary to take into account additional factors such as seasonality, difficulties in matching supply and demand, and errors in supply/demand assumptions. Taking all these into account, the ALJ found that without APL's service "the relationship of demand to capacity will be tight within the time frame of the 1990s...." Moreover, the ALJ stated: "nor can it be concluded that the availability of APL's 28,200 FEUs would severely overtonnage the trade as intervenors contend. Rather, this would leave the west bound Hawaii trade with a comfortable margin of supply over demand that should suit the shippers' needs, particularly where the shippers would be given a new alternative and flexibility for shipment of their goods by having an additional competitor such as APL in the trade." [Initial Decision pp. 133-134]

With respect to Sea-Land's announcement that it is going to add ships to the trade, we believe this validates what we have been saying all along: demand is much greater than Matson would have anybody believe.

Q-6. How do you explain your opposition to a retroactive application of the new standard for mixed services under this bill when you are attempting to have your service to Hawaii prospectively approved in ODS reform. In other words, aren't you trying to mandate legislatively, what Matson is trying to prohibit legislatively, that is, service by subsidized carrier into the domestic trades?

A: Section 805 is related to ODS reform because all such proposals would extend the program to currently unsubsidized carriers which presently have domestic operations (Sea-Land, Crowley). Thus, ODS reform legislation has had to address whether, and in what way, the domestic services of such operators should be permitted. Some members of USA have insisted that such operations be grandfathered. In turn, as a matter of fairness and a "level playing field," pending requests by ODS carriers to serve the domestic trades also should be granted by the legislation.

Q-7. In your testimony, you state that the proposed legislation will resurrect the doctrine of "fundamental entitlement" which has been rejected by the courts.

- **How in your opinion, does S. 2170 represent a return to that doctrine?**
- **Why is that not desirable?**

A: Under the "fundamental entitlement" doctrine, domestic operators in a trade were held to be "fundamentally entitled" to all the cargo they had the capacity to carry -- currently or in the future -- free of any competition from an ODS contractor. S. 2170 resurrects this standard because it would make adequacy of existing service the exclusive factor in determining whether to approve an application by an ODS contractor. Specifically, an ODS contractor would be permitted to serve a domestic trade in "mixed" service only if it is found "that the existing service provided....by all vessels is inadequate." This could be interpreted to grant existing operators fundamental entitlement to whatever cargo they have the capacity to carry.

Under Section 805(a), adequacy has been one of the factors considered, but not the only one. In addition to the interests of domestic operators, we think it continues to make good sense to take into account the interests of those who use and benefit from our services: shippers and consumers. We do not think that granting a de-facto protected monopoly to existing domestic carriers would serve those interests well.

Q-8. There seems to be quite a bit of concern that a company of APL's size would come into the domestic trade and "skim the cream off" of the domestic market, leaving the exclusively domestic carriers to be the workhorses of the trade, carrying the less valuable commodities in the trade and servicing the more remote communities.

- **Is this true? If not, what do you perceive APL's role to be in the domestic trade?**

A: No, it is not true. To begin with, the notion that APL is a Goliath and Matson is a David is mistaken and unfounded. Remember: last year Matson's operating profit was more than 10 times our own. Matson enjoys an extraordinary 24% ratio of operating profit to gross revenue. As the ALJ found, "Matson is the most profitable operator of liner vessels under U.S.-flag" and "has indicated that it expects to continue to operate profitably even if APL's application is granted."

Second, APL has committed to providing a full range of containership services to Hawii -- just as APL does in all the trades it serves -- including service to the Neighbor Islands.

Finally, the issue of "cream skimming" was raised and argued extensively in the administrative proceeding. Suffice it to say that the ALJ found there to be no basis to deny APL's application on this ground.

Q-9. I asked Matson for their views on the current standard in Section 805 prohibits an ODS contractor from diverting, directly or indirectly, assets used in its subsidized operations into its domestic operations. S. 2170 would disallow service by an ODS contractor in the domestic trade if there would be any support to the contractor's domestic operations from subsidy funds he receives in the foreign trade.

- **Do you believe there is a substantive distinction between these two standards? If so, what is that distinction?**

A: We do not believe there is a substantive distinction between these two standards. However, because it is a change in language, we are concerned that others could argue that any funds or assets that are in any way connected with a subsidized service cannot be used in domestic service. We would just note that this argument is regularly advanced by domestic operators under current Section 805(a) -- and is just as regularly rejected.

Senator BREAUX. Thank you, Mr. Rhein.

Mr. Verdon.

STATEMENT OF WILLIAM P. VERDON, PRESIDENT, UNITED SHIPOWNERS OF AMERICA

Mr. VERDON. Thank you, Mr. Chairman, and good afternoon.

I am William Verdon, President of the United Shipowners of America, and I appreciate the opportunity today to present our views on S. 2170.

The United Shipowners of America, as you know, is the national trade association which represents over 98 percent of the U.S.-flag liner companies engaged in international trade. Our members are American President Lines, Central Gulf Lines, Crowley Maritime Corporation, Farrell Lines, Lykes Brothers Steamship, Sea-Land Service, and Waterman Steamship Corporation.

Our reasons for opposing S. 2170 are that: first, the legislation is piecemeal in nature, zeroing in on only one million of the Merchant Marine Act of 1936;

Second, the legislation we believe is ill-timed, in that it addresses the very substance of an ongoing administrative proceeding, Docket No. S-801.

Let me take this opportunity on behalf of USA to briefly discuss our concerns. The piecemeal nature of S. 2170. There is a pressing need to overhaul and reform the operating-differential subsidy program that was originally enacted as part of the Act in 1936 and amended in 1970. One major impetus for reform is the need for all U.S.-flag carriers to have an opportunity to acquire vessels.

Another catalyst for reform of the ODS program was the realization that, with only a handful of U.S.-flag carriers remaining, it made no sense whatsoever to have some carriers in the ODS program and others outside of the program. The current system of four carriers operating under one set of rules and regulations and three carriers operating under a different regime has been counterproductive, to say the least, to our having an industry united in meeting foreign competition.

ODS reform or any reform of the Act should not be looked at in bits and pieces. In doing so, the end result is often that in solving one problem for one carrier another carrier is injured. The balance is delicate indeed and the interrelationships created by the Act require a very careful assessment before change can be effected.

The many failed attempts over the last decade to fix one carrier's concerns or even a group less than all is a testament to the need to look at the entire puzzle and make sure that all of the pieces fit.

For the very first time, we now have a situation where the U.S.-flag carriers in the foreign commerce of the United States have agreed to support a legislative program that comprehensively reforms the ODS program. Our program deals not just with one problem, but offers a reasoned solution to all the issues that have vexed the industry over the years.

For instance, it covers inclusion of all carriers into the program, trade route flexibility, a fiscally responsible program, a reasoned approach to the interrelationship of U.S.-flag and foreign flag utilization, the ability to replace our fleets with modern tonnage and grow in order to be able to reverse the downward spiral of our position in the marketplace, and it addresses the interrelationships between the domestic and foreign commerce U.S.-flag operators.

Addressing any one of these issues without addressing all of these issues will, unfortunately, almost always result in shifting the existing delicate balance in favor of one at the expense of another.

Addressing changes to section 805 in the context of broader ODS reform efforts is nothing new and nothing surprising. For example, the chairman will recall that in 1987 Matson and TOTE worked with predominantly foreign commerce operators, APL and Sea-Land, on prospective revisions to million 805 in the context of the chairman's then pending ODS reform proposal.

The Administration's ODS reform proposals also have addressed section 805 in the broader context.

We have submitted comprehensive reform legislation to this committee and look forward to the opportunity to further discuss our views at the appropriate time. Furthermore, many of the issues addressed by section 2 of Senate Bill 2170 are currently the subject of litigation in Docket No. S-801 before the Maritime Administration.

This case, involving an application of APL to serve Hawaii pursuant to section 805(a) of the Act, has been in litigation for over three years, at considerable expense to all the parties. This specific proceeding is now at the stage where an administrative law judge has issued his initial decision and the matter is currently awaiting a decision by MarAd.

USA believes that the proceeding should be entitled to run its course. The parties have played by the rules of the game and the rules should not be changed by single-issue legislation in the final seconds.

Mr. Chairman, that concludes my prepared remarks and I would be glad to answer or try to answer any questions that you may have. I would also ask that my letter dated April 16th to Senator Inouye be made a part of the record, and I have attached a copy of that to my testimony.

[The following information was subsequently received for the record:]

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May 30, 1990

The Honorable John B. Breaux
Subcommittee on Merchant Marine
Senate Committee on Commerce, Science
and Transportation
425 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Breaux,

Attached are USA's responses to several questions addressed by the Subcommittee as a result of the hearing on S. 2170

Sincerely,

William P. Verdon
President

QUESTIONS / ANSWERS RE. S. 2170

Question 1.

In your opinion, do problems presently exist with the current method utilized by the Secretary in granting permission to ODS operators to enter the domestic trade?

If so, what are those problems and how would you recommend that they be addressed?

Answer

USA does not believe that problems presently exist with the current method utilized by the Secretary in determining whether ODS operators should be permitted to enter domestic trades.

After the grandfathering, our comprehensive ODS reform package leaves the methodology for entry into the domestic trades as is.

Question 2.

You have stated that your association is opposed to this bill because it believes these issues are better addressed in a more comprehensive ODS reform effort.

Why is that?

What is it about a more comprehensive approach that is more appropriate than looking at the issues one at a time?

Answer

All of the issues in the current ODS program are related to each other. They do not stand alone but rather are part of an integrated program. They form a delicate balance for a program that has as its goal a healthy U.S.-flag merchant marine. Tinkering with one section without adjusting the other sections it impacts on will upset that balance. For example, the original 1936 Act required subsidized operators to use U.S.-flag vessels built in the United States. The Act recognized the severe cost differential between U.S. and foreign built vessels and provided as part and parcel of the ODS program a CDS program that would aid U.S. operators and give them the ability to build vessels in the United States.

We firmly believe that Section 805 of the Act should be considered in the context of all of the issues that need to be faced up to and resolved through comprehensive legislative reform of the ODS program. In this way we can hopefully reach a reasonable solution to all of the problems. It is important to note that several USA member companies who are prospective recipients of ODS under USA's ODS reform bill are also operators in the domestic trade. The provisions relating to Section 805 incorporated in USA's bill have been drafted in a manner to consider their concerns as operators in both foreign and domestic trades.

Question 3.

Have you consulted the affected Congressional delegation or the exclusively domestic offshore carriers in drafting your ODS reform proposal (as it relates to the issue in question here today)?

How does your ODS reform proposal address the issues raised today?

Answer

USA did consult the exclusively domestic offshore carriers and met with Matson Navigation, Tote, and PRMMI in February of this year. USA did not consult the affected Congressional delegation.

Our ODS reform proposal addresses the issues raised by S. 2170 in Section 16. (This section would grandfather in domestic operations in existence three months prior to date of enactment and would grandfather in the proposed operations of the applicant in Docket S-801.)

Question 4

Regarding S. 2170, what is the position of the members of your association that are not currently subsidized but are seeking to become subsidized?

Do they support the USA position on the bill that it would be preferable to address this issue in the context of ODS reform generally?

Answer

The position of USA on S. 2170 which is reflected in my prepared testimony and my letter of April 16, 1990 to Senator Inouye is a unanimous position of all the members of USA.

Question 5

In a letter to Senator Inouye that you attached to your statement your association opposed the retroactive application of the new "adequacy" standard to previously approved domestic operations by ODS operators, as required by S. 2170. I noticed that you did not mention your opposition to this retroactive application in your prepared remarks.

Is this still the position of USA? If so, why do you oppose such a retroactive application?

Answer

USA's prepared statement incorporated by reference and for the record the letter of April 16, 1990 to Senator Inouye. The letter, along with the prepared testimony, accurately reflects the USA position on S. 2170.

Question 6

In your opinion, should affiliated services be subjected to the same standard as is mixed service, that is, adequacy of existing service?

If not, why not?

Answer

In the context of an overall reform of the ODS program, our proposed legislation does not call for a change in the language of Section 805 dealing with the standards to be used by MARAD.

Question 7

Will any of your members be affected by the 25 year prohibition on ODS carriers entering affiliated service?

If so, how?

Answer

All of our members who currently own and/or operate CDS vessels could be affected by the prohibition in S.2170 against such vessels entering affiliated service. They might not be able to use the vessels in question in a way that they otherwise could have or they might be deprived of an opportunity to sell the vessels to another operator to so use them.

Senator **Breaux**. Thank you very much. It will be done.

Mr. **Verdon**. Thank you.

Senator **Breaux**. Mr. Stocker, your testimony.

STATEMENT OF JOHN J. STOCKER, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA

Mr. **Stocker**. Thank you, Mr. Chairman.

I am John Stocker, President of the Shipbuilders Council of America. And as you know, Mr. Chairman, the Council is the national trade association representing U.S. shipyards and suppliers of marine equipment and services. Our member shipyards employ approximately 95 percent of the private U.S. workforce engaged in ship construction and repair, and we appreciate the opportunity to comment on S. 2170.

I might indicate to you that we are appearing here today in support of S. 2170, and before I explain why we support this legislation let me describe what is occurring internationally in the shipbuilding industry. This is important if Congress is to fully understand the importance of this legislation to U.S. shipyards.

As you know, Mr. Chairman, the 1980's were devastating for the shipbuilding industry. Early in the decade, there was a worldwide glut of commercial ships, which led to few ship orders. This was especially a hard time for U.S. yards. As commercial orders declined, foreign governments substantially increased their shipyard subsidies to protect their market share and in some cases to capture even greater market share. And I think I only have to point out the case of South Korea to prove my point.

In 1981 the U.S. government compounded the plight of U.S. shipyards when it terminated funding for the CDS program. This decision, which was made at a time when foreign assistance was on the rise, rendered U.S. shipyards non-competitive in the commercial marketplace, and as a result 43 shipyards closed, 36,000 production workers were laid off, and the industry became totally dependent on the U.S. Navy for its survival. This should give us pause for concern about the future, given the current debate in Washington on where the defense budget is going.

However, as the decade of the 1990's begins there is reason for some optimism. The world's shipping fleet, and especially the U.S. Jones Act fleet, is old and in dire need of replacement. A huge upturn in commercial orders has already begun and is expected to continue throughout the decade.

We believe that as a result of a number of trends that we see in the industry, including our improved productivity in the construction of naval vessels and because of our competitive labor rates, that the price differential between U.S. unsubsidized yards and subsidized foreign shipyards is narrowing, and we are confident that if our government can attack the issue of foreign government subsidies, that we can close the gap between U.S. and foreign shipyards completely.

You may wonder why all of this is relevant to the legislation before us today. The fact is that we need a series ship production program, and it can come from only two unmet requirements:

Jones Act fleet replacement of cargo ships and environmentally safe tankers; and sealift ships to meet military lift requirements.

The combination of these market opportunities would provide the U.S. industry with a springboard to international competitiveness, including the construction of commercial ships for export.

S. 2170 is a good first step. It would encourage Jones Act ship investment. Jones Act operators, committed to adequately serving the domestic trade with modern ships built in U.S. shipyards, should not be penalized by allowing subsidized operators to enter the trade. The recent recommendation by the administrative law judge to allow a subsidized carrier into the Hawaiian trade has already caused substantial uncertainty for domestic operators and has cost U.S. shipyards at least—at least, Mr. Chairman—one ship order.

This recommendation ignores the fact that the trade is being adequately served, that dedicated unsubsidized Jones Act operators could be placed at a competitive disadvantage, and that a shipyard would lose the opportunity to build more than just one ship of a new design.

S. 2170 would also prohibit CDS-built cargo vessels 25 years of age and older being operated by subsidized companies from entering the domestic trade. This is necessary to avoid making the Jones Act trade the dumping ground for old, inefficient and unsafe ships.

If these subsidized operators are allowed to enter the domestic trade, freight rates will be depressed further. This would negatively impact dedicated domestic operators who are not subsidized and eliminate any ship replacement opportunities for U.S. shipyards.

To put this in perspective, there are 90 CDS-built cargo vessels built since 1960, for which the subsidy has not yet been repaid. Under current law, these ships will be eligible to operate in the domestic trade when they reach the end of their 25-year statutory life, 16 of these ships are eligible to enter the domestic trades today, and by 1995 another 27 vessels would be eligible to operate in the Jones Act. If this is allowed to occur, U.S. shipyards and Jones Act operators could be devastated.

U.S. policy should discourage the Jones Act from becoming a dumping ground. Our policy should be to encourage a safe, modern Jones Act fleet, which would in turn ensure domestic construction and repair capability for this trade, and others, at competitive prices.

Thank you for this opportunity to express our support for S. 2170, and we would ask that the full statement be entered into the record.

[The statement and questions and answers follow:]

STATEMENT
OF
JOHN J. STOCKER
PRESIDENT
SHIPBUILDERS COUNCIL OF AMERICA

Thank you Mr. Chairman, members of the Subcommittee, I am John Stocker, President of the Shipbuilders Council of America. The Council is the national trade association representing U.S. shipyards and suppliers of marine equipment and services. Our member shipyards employ approximately 95 percent of the private U.S. workforce engaged in ship construction and repair. A membership list is attached.

It is my pleasure to testify today in support of S. 2170. This legislation would amend the Merchant Marine Act of 1936 (46 App. U.S.C. 1223 (a)) to prescribe the conditions under which contractors - receiving operating-differential subsidies (ODS) or their affiliates - may engage in coastwise or intercoastal trade. The purpose of this bill is twofold. It would prohibit a subsidized operator of bulk vessels from entering the domestic trade if the trade is currently being adequately served and it would prohibit liner ships (25 years of age and older - built with construction-differential subsidies (CDS)) from operating in the domestic trade if the operator is subsidized, directly or indirectly, by the Federal Government.

Before I explain why we support this legislation, let me describe what is occurring internationally in the shipbuilding industry. This is important if Congress is to fully understand the importance of this legislation to U.S. shipyards.

As you know, Mr. Chairman, the 1980s were devastating for the shipbuilding industry. Early in the decade, there was a worldwide glut of commercial ships which led to few ship orders.

This was an especially hard time for U.S. yards. As commercial orders declined, foreign governments substantially increased their shipyard subsidies to protect their market share and, in some cases, to capture even greater market share. In 1979, for example, South Korea accounted for only 3.4 percent of the world market. The U.S. share was 8.7 percent. Today, South Korea garners 23 percent of the market while the U.S. hangs on with only one ship on order.

In 1981, the U.S. Government compounded the plight of U.S. shipyards when it terminated funding for the CDS program. This decision -- which was made at a time when foreign assistance was on the rise -- rendered U.S. yards noncompetitive in the commercial marketplace. As a result, 43 shipyards closed, 36,000 production workers were laid off, and the industry became totally dependent on the U.S. Navy for its survival.

As the decade of the 90s begins, however, there is reason for much optimism. The world's shipping fleet, and especially the U.S. Jones Act fleet, is old and in dire need of replacement. A huge upturn in commercial orders has already begun - and is expected to continue throughout the decade.

Because of reduced shipyard capacity to meet the increased demand for new ships, prices have more than doubled in the last two years. In spite of foreign subsidies, the price differential between U.S. and foreign shipyards has been closing and closing dramatically.

U.S. shipbuilders now have an opportunity to reenter the commercial market. I say this because of the tremendous strides our industry has made in improving productivity in the construction of naval ships and because of our competitive labor rates today. The average U.S. labor rate is now $5 an hour below Northern Europe and on par with Japan. Most importantly, however, is that our government is now engaged in negotiations with our foreign trading partners to end shipyard subsidies worldwide. If subsidies can be eliminated, the U.S. yards have a fighting chance to win commercial contracts. If our trading partners reject subsidy discipline, then the issue to be addressed will be how to equip U.S. yards with the tools to capture market share from the European and Asian producer.

As a result of these trends, we are confident that the price gap between U.S. and foreign shipyards can be closed completely. To do this, it is essential that all forms of foreign subsidies be eliminated, and that U.S. shipyards are provided a bridge program. U.S. industry must have a series commercial ship construction program to enable it to catch up with the foreign yards that have benefitted by ten years of subsidy and commercial experience. A series production would allow U.S. yards the opportunity to transfer the productivity improvements it has made in the construction of naval ships to the construction of commercial ships. It would also enable yards to invest in new plant, equipment, and training to optimize commercial productivity.

It stands to reason that a U.S. company with none - or only one - commercial ship under construction cannot compete overnight with a shipyard that has a large, established series production line. Japan, for example, has 400 commercial ships on order or under construction today compared to only one ship in the U.S.

You may wonder why this is all relevant to the legislation before us today. The fact is that a series ship production program can only come from two unmet requirements: Jones Act fleet replacement of cargo ships and environmentally safe tankers, and sealift ships to meet military lift requirements. The combination of these market opportunities would provide the U.S. industry with the springboard to international competitiveness -- including the construction of commercial ships for export.

S. 2170 is a good first step. It would encourage Jones Act ship investment. Jones Act operators - committed to adequately serving the domestic trade with modern ships built in U.S. shipyards - should not be penalized by allowing subsidized operators to enter the trade. The recent recommendation by the Administrative Law Judge to allow a subsidized carrier into the Hawaiian trade has already caused substantial uncertainty for domestic operators and has cost U.S. yards one ship order. This recommendation ignores the fact that the trade is being adequately served, that dedicated unsubsidized Jones Act operators could be placed at a competitive disadvantage, and that a shipyard would lose the opportunity to build more than just one ship of a new design.

In January of this year, Matson Navigation Company placed an order with a U.S. yard for the construction of one specialized ship designed especially for the Hawaiian trade.

The company had originally planned to order two new ships before this recent recommendation to MARAD. When only one ship of a design is built, the price of that ship must include all of the nonrecurring costs. For example, Matson has stated that the one-time engineering and design cost is $18 million to $20 million. This does not include the cost of lofting, planning, scheduling, jigs, and fixtures which are also associated with a new design. Furthermore, a yard cannot take advantage of material price discounts offered by equipment suppliers for multiple ship set orders.

Consequently, the U.S. price of $129 million for this one ship has resulted in undeserved criticism. I point this out because of the grossly inaccurate speculation on the part of many that if this ship had been built in another country it would have been built for as little as a third of the U.S. price. This is absolutely false.

Those who have speculated that the ship is two to three times the foreign price are quoting a mid-series, subsidized price for a standardized containership. They have ignored the highly customized characteristics of the U.S. design which must be able to accommodate both 24-foot and 40-foot containers--some of which are refrigerated--as well as special auto frames for carrying cars which must fit into the container cells.

Most foreign yards will not build just one ship per design for these very reasons. In fact, foreign yards do not provide their commercial customers with anywhere near the degree of customized service and design provided by U.S.

yards. Only minimal changes will be made to a standard foreign design for a customer in order to keep the cost down. (I might add that this is precisely why Japanese shipyards oppose double hulls on tankers. It would change production techniques, reduce the number of ships produced per dock per year, and increase work load over current designs. This would in fact give U.S. yards a competitive advantage.)

S. 2170 would also prohibit CDS cargo ships, 25 years of age and older operated by subsidized companies, from entering the domestic trade. This is necessary to avoid making the Jones Act trade the dumping ground for old, inefficient, unsafe ships. If these subsidized operators are allowed to enter the domestic trade, freight rates will be depressed further. This would negatively impact dedicated domestic operators who are not subsidized and eliminate any ship replacement opportunities for U.S. yards.

To put this in perspective, there are 90 CDS cargo ships, built since 1960, for which the subsidy has yet been repaid. Under current law, these ships will be eligible to operate in the domestic trade when they reach the end of their 25-year statutory life. Sixteen of these ships are eligible to enter the domestic trades today, and by 1995 another 27 ships would be eligible to operate in the Jones Act. If this is allowed to occur, U.S. shipyards and Jones Act operators could be devastated.

U.S. policy should discourage the Jones Act from becoming a dumping ground. Our policy should be to encourage a safe, modern Jones Act fleet which would in turn ensure domestic construction and repair capability for this trade - and others - at competitive prices.

Thank you for this opportunity to express our support for S. 2170. I will be happy to answer any questions.

QUESTIONS OF SENATOR BREAUX AND THE ANSWERS

1. What is your position on the proposed bill?

   - o In your opinion, how will the change in Section 805 from the "unfair competition" test to the "adequacy" test affect your members?

The recent recommendation by the Administrative Law Judge has already cost U.S. shipyards one ship order. Matson Navigation Co. had originally intended to build two new ships as opposed to one until uncertainty was imposed upon the trade by the APL application. If "adequacy" were the test, this would not have occurred.

   - o How will the proposed prohibition of the use of a 25 year old vessel in domestic trade affect your members?

Without some restrictions on 25 year old ships, these vessels will be placed into the domestic trades and reduce the need for replacement tonnage.

2. What, if any, effect would changing the standard governing entry by subsidy carriers into the domestic trade have on the U.S. shipbuilding industry?

   - o Would there be any effect on the U.S. shipbuilding industry, and especially any current ship construction contracts if the proposed changes are not enacted into law? In other words, would there by any effect on existing or potential ship orders?

The answer to these first two questions is covered above.

   - o How many orders for construction of U.S. cargo ships are currently held by U.S. shipyards?

One cargo ship is currently under contract.

   - o What company has ordered those ships?

Matson Navigation Company

3. In your testimony you state that S. 2170 would prohibit a subsidized operator of vessels from entering the domestic trade if that trade is currently being adequately served. It was my understanding that the new "adequacy" test in the bill applies to liner vessels and that the existing standard for bulk vessels is retained.

   - o Which interpretation of the bill is correct?

Liner Vessels

4. I am concerned about the provision in the bill which would disallow vessels owned by an affiliate of an ODS operator that were built with CDS to enter the domestic trade after the vessels reach 25 years of

age. Some of our shipping companies in Louisiana have vessels that are nearing their 25th year. These are the same companies that cannot afford to make major capital investments in ships at this time and whose ODS contracts are expiring. If these companies can no longer receive ODS on those vessels and they can't use the vessels in domestic trade what would you expect these companies to do - go out of business? That would not be good for any U.S.-flag company or for U.S. shipbuilding interests.

The Shipbuilders Council certainly does not wish ill for any shipping company. However, if 25 year old ships are allowed into the domestic trade, this tonnage could replace older tonnage which would otherwise need to be replaced by new construction. Thus, shipyards in Louisiana will lose construction opportunities and could also face financial difficulties. In view of the cuts in defense spending, the future for shipyards is dependent on commercial ship orders. If Louisiana operators do not have the financial capability to replace their aging fleet today, what assurance do you have that their financial condition will improve years from today. Making policy decisions that in the short-term appear to sustain an operator while negatively impacting shipyard does not seem to me to be in the best interest of anyone.

o You stated in your testimony that entry of these vessels into the domestic trade would depress freight rates even further than their current levels. How is this so?

The Jones Act fleet's average age is over 20 years. When vessels reach 20 years in the case of a tanker and 25 years in the case of a general cargo ship, the capital costs should have been completely amortized. Therefore, an operator of a vessel with no remaining capital debt can offer much lower freight rates than an operator with a relatively new ship. When the majority of the fleet is old, an operator with a new ship is placed at a competitive disadvantage if the freight rates aren't high enough to cover the capital investment.

5. You stated in your testimony that the Administrative Law Judge's initial decision in the APL Section 805 application at MARAD would result in a shipyard losing the opportunity to build more than just one ship of a new design.

o What do you mean by that statement?

As I stated earlier, Matson had intended to order two ships of the same design for its West Cost to Hawaii trade. When uncertainly was injected into the trade because of APL's application, Matson reduced their order book to one. APL does not have a requirement for new tonnage regardless of MARAD's decision.

6. In your testimony, you stated that the price of ship construction has more than doubled in the last two years because of reduced shipyard capacity to meet the increased demand for new ships. I was under the belief that U.S. shipyards were suffering for lack of business.

o If there is such limited shipyard capacity, how will we have the capacity to replace our Jones Act fleet, which you so aptly describe as "old and in dire need of replacement?"

- o Why will the provision in the bill that prohibits the domestic use of CDS-built vessels over 25 years of age not exacerbate this problem?

I was referring to international shipyard capacity. As ship orders declined during the 80's, shipyards downsized or closed to meet the reduced demand. In the 1990's, however, ship orders are on the rise to replace the world's aging fleet. U.S. shipyards want to participate in that market because we do have capacity. In fact, there is today, sufficient capacity in the U.S. to replace the entire Jones Act tanker fleet in eight years. This analysis was based on available operating facilities. It did not include yards at capacity with Navy work. Unfortunately, even greater excess capacity will exist in the U.S. as the Navy shipbuilding budget declines.

Senator **Breaux**. Thank you very much, Mr. Stocker.

I am trying to figure something out. Just a second. [Pause.]

Just as a point of clarification, Mr. Stocker, I noticed on the first page of your testimony you say: "The purpose of the bill is twofold. It would prohibit a subsidized operator of bulk vessels from entering the domestic trade if the trade is currently being adequately served."

Am I misreading the bill? I interpret it not to cover bulk vessels.

Mr. **Stocker**. No, it is oriented to liner vessels. That is a mistake in the testimony.

Senator **Breaux**. Okay.

Let me start with Mr. Rhein then. How much, Mr. Rhein, does APL get in subsidies currently?

Mr. **Rhein**. I believe the number for 1990 is projected to be around $55 million.

Senator **Breaux**. How much would you project that the company would have to give up if your current application would be approved, in ODS? That is a matter of public record, I guess.

Mr. **Rhein**. I think it is around $2.5 million per year to $3 million.

Senator **Breaux**. So you would have $52.5 million in remaining subsidy. And my question is, how can your company that would be operating the vessels and that would be giving back to the government $2.5 million subsidy not be positively affected by the $52.5 million that your company would also be getting in your subsidized operations?

Mr. **Rhein**. Senator, the $55 million and the $52.5 million are designed under the law to equalize the crew wage costs for an American crew in international trade versus a melting pot of foreign crews. Every dime of the subsidy we get is used exclusively for that purpose.

Senator **Breaux**. So your point is that there is no cross-subsidization possible because there is no money left?

Mr. **Rhein**. That is entirely accurate, Senator. There is nothing left. As a matter of fact, there is not enough.

Senator **Breaux**. The proponents of the legislation argue that because of the subsidy that you are receiving, you are enabled to take more risk than the carriers that would not be receiving ODS, that you could perhaps charge less, knowing that you are protected in the other half of your operations, that you are willing to perhaps take the risk of losing with unsubsidized vessels knowing that you are going to be guaranteed, not a profit, but be guaranteed a better situation with those vessels that are operated.

It enables you, in other words, to take more risk, to charge less, knowing that you are going to be protected and have a guaranteed source of income from the ODS vessels. What is your response to that?

Mr. **Rhein**. That is a complicated question, but there is an answer. In terms of staying power, as I mentioned previously, 100 percent of the subsidy is a pass-through in terms of equalizing crew wages. Therefore, there is nothing left to use for other purposes.

We are involved in international trade in the Pacific against 25 other carriers, 24 of which are foreign carriers. If we are talking about staying power, the profitability of the international carriers is so minimal that I would really question the staying power of any American carrier in international trade.

APL's profit the last year was $11 million on gross sales of well over $2 billion. Matson, if you are looking for staying power, made $124 million on $400 million. I will admit to jealousy, but in terms of staying power I would much rather be on their side than ours.

Senator **Breaux**. Do you think, and if so why, that the current service to the Hawaiian trade from the West Coast or the mainland is adequate or inadequate?

Mr. **Rhein**. I would prefer, on this particular question, I would prefer to refer to the administrative law judge, who found that the trade was minimally adequate, based on the assumptions that were applied or that were evident in the lengthy hearing.

Again, to editorialize a little bit, the question of adequacy is one that is poorly defined, but in our view the trade is inadequate in terms of coverage, because it is a much more complex question than just capacity offered. There is seasonality of the capacity. The Hawaii trade, similar to any other trade, has peaks and valleys of activity.

There is inadequacy in terms of services offered. There is inadequacy, grievous inadequacy in our opinion, in terms of competition. It is a monopolistic trade dominated by Matson, which has a 75 percent market share. There is little, if any, improvement in service over the many years that they have monopolized the trade.

There is no service competition, there is no rate competition, there is no intermodal competition in terms of new innovation, equipment innovation, telecommunications and customer interfaces utilizing modern techniques and technologies that are available to those carriers that must compete on a free enterprise, free trade basis, of which APL is a leader.

Senator **Breaux**. The proponents of the legislation said that cost should not be considered in an adequacy determination. Do you agree with that, cost of the service?

Mr. **Rhein**. No, I think cost is clearly a consideration.

Senator **Breaux**. How is the question of the prohibition of cross-subsidization handled under current section 805 proceedings? In other words, what are the guarantees that there is no leakage of the subsidy into the non-subsidized vessels?

Mr. **Rhein**. My understanding of the current provisions of 805(a) is that leakage is prohibited.

Senator **Breaux**. Well, having said that as a policy it is illegal to rob a bank, the question is what is in the law that assures that that does not occur? I mean, are there reports that have to be filed? Are there statements of where the subsidy goes that has to be filed to ensure that the ODS is used only for those vessels it was intended for?

What guarantees the Congress and the American taxpayer that there is not a violation of the prohibition? The prohibition is clear. What do you have to do to help MarAd ensure that there is not any leakage?

Mr. **Rhein**. Senator, the ODS program is administered by the Maritime Administration on a ship basis, and it is based on their evaluation of competitive factors, on the crews of, again, a melting pot of competitive ships for a particular timeframe.

In the case of a mixed service that operates both in a domestic and an international trade, that ODS is administered per ship, and the payback formula is determined by the Maritime Administration. So it is not our calculation as to what we are entitled to, but the government's. So we are assuming that it is correct when it is given to us.

Senator BREAUX. Assuming for the sake of argument—perhaps ODS operators would laugh at this, but assuming for the sake of argument that ODS subsidy exceeds the cost of the operations—you are laughing. Maybe all ODS operators would laugh. But what would happen to the excess? I mean, maybe that is just not possible. Maybe it is a stupid question.

Mr. RHEIN. It is a rhetorical question, but if that were the condition we would be obligated to turn it back.

Senator BREAUX. Okay. The point on the adequacy and the current standard of unfair competition. There has been testimony from MarAd, which some would argue has been clear and some would argue that it was very unclear. I get the impression that under the current section 805, in determining whether the application's approval would create unfair competition, that a question of adequacy of current service is one of the considerations.

What is the problem from your perspective with a bill that requires adequacy as a consideration in the test if adequacy is in fact, already being considered?

Mr. RHEIN. Well, Senator, the problem with that is that the current law is time-tested and proven to already address that issue. This particular piece of legislation is a narrowly focused, retroactive, almost punitive piece of legislation to protect a monopoly, and has nothing to do with the rightness or wrongness of section 805(a) in my opinion.

Mr. Mulholland testified, if I may, that there has been no history of any inadequate service being approved, and we agree with that. This law has been on the books since 1936, and as a matter of fact as recently as 1980 Matson recommended approval of U.S. Lines' application for mixed service of an ODS carrier to Hawaii.

In the 1950's, Matson operated as a subsidiary of Oceanic Steamship Company, which was a mixed ODS recipient operating from the West Coast to Hawaii to Australia and New Zealand, under the same law that we applied under three and one-half years ago, playing by the rules, having spent millions of dollars to now get to the one-yard line, and have Matson or whoever introduce this special purpose, narrowly focused, retroactive, non-competitive, non-consumer, non-deregulation, and anti-trade piece of legislation.

Senator BREAUX. You are against the bill?

Mr. RHEIN. I have to reflect on that.

Senator BREAUX. My question probably is also a little bit more narrow than that, also, in the sense of what I am trying to determine—I got the impression from Mr. Patton that adequacy is one of the things they look at right now under the current set of regulations and policies in determining whether there would be unfair competition if an 805 application were to be approved.

My question to you is that the bill says "adequacy" shall be considered. What is wrong with that, if in fact that is already part of the mix under the current system? What is wrong with a bill that says "adequacy" is the criterion, if in fact it is already being considered in their determinations?

Mr. RHEIN. This is a question, Senator, of definition. The adequacy in S. 2170 is narrowly defined as capacity available in the trade. "Adequacy" as interpreted under the 1936 existing law is a much broader issue that concerns consumers, concerns shippers, concerns competition and service, in addition to capacity available in the trade.

And we object to a narrowly focused definition of "adequacy" along pure capacity lines. This is a much more complex question than that.

Senator BREAUX. You would argue that the bill sets out adequacy as the primary criteria for approving an application?

Mr. RHEIN. I think it is the only criteria, Senator. And I would like to add that if capacity in the trade were the only criterion, I would really question why carriers such as ours would be interested in entering the trade or Sea-Land would be adding a new service.

There clearly is some demand in this particular trade for more than just capacity.

Senator BREAUX. That was another question I wanted to ask you, and that is how do you interpret Sea-Land's expressed interest in becoming involved in the trade? What does that mean to you?

Mr. RHEIN. It means validation of what we have been saying all along, that demand is much greater than Matson would have anybody believe. And we have heard that continuously since the last three and a half years from the shipping public in Hawaii.

Senator BREAUX. In your opinion, should there be any difference in the treatment of affiliated services as opposed to mixed services in the treatment of an 805 application?

Mr. RHEIN. I have no opinion on that, sir.

Senator BREAUX. Mr. Verdon, I guess I am hearing from you essentially that, we are working on some other legislation that we have been working on since I have been in Congress, since 1972 I guess, that we should address these problems at that time.

I guess some would argue that that day may never come; you better get it fixed as quickly as you can. What is wrong with that?

Mr. VERDON. Well, I think the difference and what is wrong with that is that we have finally amongst ourselves done something that we have not done since you have been in Congress, and that is agree to a comprehensive program. We have submitted it, not only to this subcommittee, but to the House as well, and have asked that hearings be had on request in both the houses to look at these things under the light of good, constructive dialogue, not only amongst ourselves, but with others such as the shipbuilders and the unions and the domestic carriers.

And we think that the program we put forward is a reasoned approach to solve all of the problems. We recognize the real world, that there is going to be and there may well be a difference. We have spoken with some of the domestic carriers that are involved and have argued our position to them outside the confines of this building, and we have not been successful.

But that does not mean that when we can get it all together in an entire comprehensive package that can finally solve this problem, that it may not—either side may have to go back and caucus as to what their positions were. We do not look at—we would like to think that what we put forward is absolute, period, and not a dot should be changed. But in the real world, it is put out there for the very purpose of getting the dialogue going.

Senator **Breaux**. What is your group's recommendation with regard to the limitations on an ODS operator? What are your recommendations going to be?

Mr. **Verdon**. With regard to section 805, what we put forward was twofold. One was that existing operators who are there and have service as of three months prior to date of enactment would be grandfathered in, and that would involve the existing carriers who are not subsidized, but have had for four, ten, 20 years, have had a service into the domestic areas. Crowley has one, Sea-Land has one, Central Gulf has some of those certain things.

Secondly, we have recommended in our legislation that APL's application be grandfathered in.

Thirdly—and there was a third one that I forgot. Thirdly, the non-liner service, rather the contract service on a domestic basis, such as your barge service up and down the Mississippi, would be forever excluded from the confines of section 805, because it really is a totally different business, that would hamstring those kind of operations.

Senator **Breaux**. So your recommendation would keep the section 805? It would keep the prohibition of the ODS operator entering into the domestic Jones Act trades unless they get an 805 type of waiver or approval through that process?

Mr. **Verdon**. That is correct, Senator.

Senator **Breaux**. And do you change the standards or recommend that we change the standards of what would be required in order to get a section 805 waiver?

Mr. **Verdon**. We do not. Our bill does not recommend any changes in the existing standards.

Senator **Breaux**. Do your members feel that the current unfair competition standard includes consideration of adequacy?

Mr. **Verdon**. I think that that's a difficult question, in light of the fact that two of our members are involved on different sides of the coin in the administrative proceeding that is going on. But we do—indirectly I can answer it by saying that our position that we all jointly agree on is, as part of an overall ODS package, if we can do that, that we would support the existing language that is in section 805.

Senator **Breaux**. Your position is that section 805 is adequate?

Mr. **Verdon**. The language is adequate.

Senator **Breaux**. Without the addition of the word "adequacy"?

Mr. **Verdon**. Without the addition of the word "adequacy."

Senator **Breaux**. Mr. Stocker, one of the things that you hit upon in your testimony was the question of what we do with 25 year old vessels that are currently allowed to get into the trade, even though they are ODS vessels, because after 25 years the CDS has been paid back?

Mr. **Stocker**. CDS, that is right. Current law would allow those 25 year old vessels to come into the Jones Act, and we think that as a matter of policy we need to review that issue to ensure that we do not see old ships just dumped back into the trade.

Senator BREAUX. And you feel—and I can understand that—that to allow—let me ask you the question, rather than state your position. Why do you feel that the current situation with regard to the 805 waivers that would allow an ODS operator to pay back his subsidy is not the right policy and needs to be changed?

Mr. STOCKER. Well, Mr. Chairman, our general position in regard to the Jones Act is that the sanctity and the purity of the Jones Act should be maintained. That is why we have argued for tightening up the rules on the issue of vessel rebuilding, and that is why we have argued that the whole issue of repair be looked at as well.

We are concerned about any crossover from the subsidized to the unsubsidized part of the market in general, and we are in particular concerned about this issue of the older vessels being dumped back into the trade, largely because we look at the average age of the Jones Act fleet in general, and we think that by comparison to what is happening in the international market, it is a disgrace to the United States that we have a domestic fleet as old as it is.

So as a matter of policy we should encourage the development of the use of modern and efficient tonnage in the trade. And we have had policy statements that have been made over the past ten years that seem to be at such cross-purposes with each other that it has made it impossible for Jones Act operators to make investment decisions.

Senator BREAUX. I guess from the shipbuilders' standpoint your position would be that to prevent ODS operators or make it more difficult for them to get into domestic trade will encourage additional U.S.-built ships to be constructed for the domestic trade?

Mr. STOCKER. Yes, we do.

Senator BREAUX. Let me ask Mr. Rhein one other point. The proponents of the legislation made the point, I think, that there has been some inconsistency in the way MarAd has applied the 805 standard and that they have been up and down and all over creation with regard to what they looked at in making these applications, and therefore legislation is needed from Congress to once and for all clearly say what the test is going to be.

Do you have any comments on that? Have they been up and down?

Mr. RHEIN. Senator, in my opinion and the opinion of my colleagues there has been considerable consistency in the application of 805(a). The purpose of this legislation as proposed is purely and simply to protect Matson's monopoly.

Senator BREAUX. Okay. I think we have probably exhausted the questions that I can think of, at least right now. The issue is obviously very complicated. We probably will have some—and I say this to all the witnesses—some additional questions that we would like to submit and hopefully get some responses in a timely fashion.

I thank all the witnesses and all of our guests for being here.

This meeting of the subcommittee will be adjourned.

[Whereupon, at 4:42 p.m., the subcommittee was adjourned.]

[The following information was subsequently received for the record:]

STATEMENT OF

TOBIAS E. SEAMAN

PRESIDENT NATIONAL ASSOCIATION OF SHIPPERS CONSIGNEES AND CONSUMERS FOR MARITIME AFFAIRS

Mr. Chairman and Members of the Subcommittee, I am Tobias E. Seaman, President of the National Association of Shippers, Consignees and Consumers for Maritime Affairs (NASCCMA). I appreciate this opportunity to submit this statement to the Subcommittee concerning S. 2170, a bill that would amend Section 805(a) of the Merchant Marine Act, 1936.

NASCCMA is a non-profit corporation organized to encourage and secure the establishment of just and reasonable rates and practices by common carriers by water.

NASCCMA and its members are strongly opposed to Senator Inouye's bill that would limit competition in the coastwise and intercoastal trades.

NASCCMA offers the following observations and suggestions to assist the committee in passing legislation that will develop a strong and effective American Merchant Marine.

With due respect for Senator Inouye who introduced S. 2170, this bill should be rejected for the following reasons:

1. S. 2170 is contrary to the intent and purpose of the Merchant Marine Act, 1936;
2. S. 2170 is contrary to the National Transportation Policy of the United States;
3. S. 2170 is contrary to public interest; and
4. S. 2170 is procedurally "tainted".

In conducting the 1935 hearings on the Merchant Marine Act, Royal S. Copeland, Chairman of the Senate Committee on Commerce, advised the witnesses that testified before his committee that he desired frankness in their testimony. He encouraged them not to be afraid to be candid. Senator Copeland's remarks are appreciated and applied to my comments today.

You have heard from Matson Navigation Company (Matson) that this bill merely "reaffirms" provisions of the Merchant Marine Act, 1936. Nothing could be further from the truth.

The only thing that this bill "reaffirms" is Matson's ability to use whatever means that are necessary to protect its claim to Hawaii's sealanes. The bill "reaffirms" Matson's continued efforts to persuade Congress[1] to create new Sec. 805(a) barriers that would not only prevent future competition from entering the Hawaii trade but would also overturn current MarAd approval of American President Lines (APL) entry into a trade where competition is much needed.

While Senator Inouye's strong support for Matson on this issue is a matter of public record[2] the record of this bill should show that the underlying purpose of S. 2170 is to protect Matson from competition. The Senator is asking Congress to overturn a long line of MarAd and Court decisions, decisions that have rejected Matson's claims that it is "fundamentally entitled" to all the cargo in the Hawaii trade. I ask the Committee not to let this happen.

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[1] See, e.g., A Bill to Amend The Shipping Act of 1984 Regarding Certain Practices of Foreign Carriers or Other Persons Providing Maritime or Maritime-Related Services in Foreign Countries, and for Other Purposes: Hearing on S. 1183 Before the Subcommittee on Merchant Marine of the Committee on Commerce, Science and Transportation, 100th Cong., 1st Sess. (May 20, 1987) (Statement of Philip M. Grill, Matson Navigation Company); Liner Development Act of 1986: Hearing on S. 2662 Before the Subcommittee on Merchant Marine of the Committee on Commerce, Science, and Transportation, 99th Cong., 2d Sess. 110 (1986) (Statement of David F. Anderson, Matson Navigation Company).

[2] See, e.g. "Inouye says APL should stay out" Honolulu Advertiser January 5, 1988 B5; and "I have to look after my Matson Lines", Senator Inouye's stated reason for asking top MarAd administrators about APL's application and MarAd's policy toward granting Sec. 805(a) applications at a hearing, the purpose of which was to make appropriations to the maritime Administration. An Act Making Appropriations for the Departments of Commerce, Justice, State, The Judiciary, and Related Agencies [Maritime Administration]: Hearing on H.R. 2763 Before a Subcommittee of the Committee on Appropriations United States Senate, 100th Cong., 1st Sess. (Part 1, p. 132, 133 and 163).

Senator Inouye, to justify a bill to overturn APL's pending application, has attacked the Maritime Administration's ability to read the Merchant Marine Act, 1936.

Senator Inouye, with Matson and Totem Resources Corporation (Totem) concurring, state that the purpose of the Merchant Marine Act, 1936, is not only to promote and develop a strong merchant marine, but: (1) To separate the merchant fleet into a "domestic" fleet and a "foreign trade" fleet. (2) To give the domestic operators a right of first refusal to domestic cargo, and (3) the subsidized foreign trade operators are precluded from domestic trade service.

> "Totem Resources Corporation applauds Senator Inouye's efforts to strengthen the separation between subsidized foreign carriers and unsubsidized domestic carriers which Congress intended."
> Statement of TRC, page 1

I disagree with this interpretation of the 1936 Act. It was the intent of Congress in 1936 to build an effective American Merchant Marine, not to create separate fleets.

> "It is our thought, the thought of all concerned, to build up an effective American merchant marine. That is what we hope to do upon the preparation of a bill."
> Royal s. Copeland, Chairman,
> Hearings before the Committee on Commerce, Part 2, p. 108.

Further, it is just as important today, if not more so, than it was in 1936 to develop our foreign commerce and reduce our trade deficit. Congress should work toward this end.

There is no justification to give preference to Matson "the most profitable operator of liner vessels under U.S.-flag" over that of subsidized carriers that would become more efficient and more profitable by providing service to the intercoastal trade.

S. 2170 is directed toward APL:

> "As provided in section 5 of the bill, S. 2170 would apply to APL's application to require that any permission granted on the application would be terminated if found not to conform with the restated requirements of Section 805(a)."

Matson's Testimony

The Shipbuilders Council of America and Matson would have this Committee believe that:

> "The recent recommendation by the Administrative Law Judge to allow a subsidized carrier into the Hawaiian trade has already cost U.S. yards one ship order.
>
> ...In January of this year, Matson Navigation Company placed an order with a U.S. yard for the construction of one specialized ship designed especially for the Hawaiian trade. The company had originally planned to order two new ships before this recent recommendation to MARAD."

The administrative record before MarAd shows that Matson changed its plans for new vessel construction orders from two vessels to only one vessel more than a year before ALJ's decision.

> "APL notes that Matson's original position was it would add two new vessels to its fleet in 1992. However, later Matson indicated that alternative plans were being considered which would involve only one vessel."
>
> (ALJ initial decision, p. 127)

Matson's decision was based on the fact that it could not wait until 1992 for additional capacity.

> "Matson has forecast for planning purposes that demand will exceed supply for Hawaii prior to delivery of its new vessel or vessels in 1992."
>
> (ALJ initial decision p. 133)

It purchased the Kaimoku (formerly Atlantic Spirit) from Crowley Maritime Corp. for $35 million (at one third the cost of the shipyard order) in September 1989 -- a month prior to the ALJ decision.

> "[Matson's Hawaii Area Manager Bob Dawdy] said the ship [Kaimoku] has been put into immediate service to meet the current high demand for cargo."
>
> Pacific Business News, Sep. 18, 1989

Further, the Shipbuilders Council of America and Matson would have this Committee believe that the ALJ erred in his decision to grant APL's application to serve Hawaii because the trade was being adequately served without APL.

This is intended to mislead the Committee to support S. 2170 to prevent this alleged "misapplication of Section 805(a)" and to "prevent current and future applicants from taking advantage of the agency's deviation from the statutory goals."

> "The recent recommendation by the Administrative Law Judge is to allow a subsidized carrier into the Hawaiian trade ... This recommendation ignores the fact that the trade is being adequately served."
>
> Shipbuilders Council of America Testimony.

Matson incorrectly claimed:

> "The ALJ found on the record that existing service to Hawaii would be adequate, not only in 1990, the projected first year of domestic operation, but at least until 1995. Despite that finding, the ALJ recommended granting the requested permission."
>
> Matson Testimony, p. 11

Matson has distorted the findings of the ALJ. The ALJ presented initial projections of demand and capacity (not adequacy of service) before presenting challenges to those estimates by APL. What the Judge stated at p. 125 is:

> "...the demand, using either APL or Matson figures, would not catch up with the 1990 capacity until 1995."

The Judge then proceeded to list numerous challenges to those figures (see Initial Decision, p. 125-133). On page 133 of his decision he states:

> "On Analysis, it appears that many of APL's points are well taken. It is reasonable to conclude that, with both Matson and Sea-Land positing the addition of new capacity in the form of new vessels or further sailings, the relationship of demand to capacity will be tight within the time frame of the 1990s."

The ALJ concluded that the trade would not be adequately served by Matson and Sea-land in 1990.

Purchases of four (4) vessels by Matson and Sea-land during the period late 1989 and early 1990 verify his findings. Matson Vice President, Glen R. Rogers, in describing the sequence of events which led to the purchase of the CAGUAS (KAINALU),

> "In the fourth quarter of 1989, Matson began experiencing high levels of container freight and auto shipments which approached lift capacity. . .
>
> By mid-January of 1990, preliminary cargo volume reports indicated that the high demand experienced in the fourth quarter of 1989 was continuing into January of 1990. . .
>
> As soon as we realized that demand could soon outstrip capacity, we acted quickly to fill the gap.
>
> . . . Matson purchased the KAIMOKU and KAINALU and put them into immediate service. . .
>
> these two vessels were purchased to fill the interim capacity needs of the trade before the entry of new construction in 1992."
>
> Surrebuttal Testimony Glen Rogers, Matson Navigation Company, In pp. 3, 21, 35 FMC Docket 90-09.

and:

> "Sea-land has announced publicly (article in Journal of Commerce, May 17, 1990, p. 1) that it will double its capacity to Hawaii in the last quarter of 1990. Sea-land acquired two U.S.-flag ships built in 1980, the EDWARD RUTLEDGE and BENJAMIN HARRISON, from the Maritime Administration. After conversion to add cell guides for containers, the ships will have a capacity of 1,650 TEUs ("twenty foot equivalent unit") each. These two vessels, along with three other vessels, will be used in a new, weekly express service between U.S. West Coast ports, Hawaii and Asia beginning in the fourth quarter of 1990. With the increased capacity, Sea-Land will be able to provide weekly port calls in Tacoma and Oakland and direct service to Honolulu from Long Beach, resulting in two calls per week in Hawaii."
>
> Surrebuttal Testimony, Glen Rogers, Matson Navigation Co. p. 34-35, FMC Docket 90-09

S. 2170 IS PROCEDURALLY "TAINTED" AND THEREFORE SHOULD BE REJECTED.

Senator Inouye, in introducing S. 2170, has requested an even playing field in the shipping industry. This can not be accomplished if the Subcommittee on Merchant Marine denies the shipping public who oppose the bill an even chance to be heard. The Committee has closed its eyes and ears to an important segment of the industry.

"Ships do not move cargo, cargo moves ships." Representatives from the shipping community made repeated requests to have an opportunity to testify at the hearings on S. 2170. The Subcommittee on Merchant Marine ignored those requests and no shipper was allowed to testify on this

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Requests for permission to testify at the hearings on S. 2170 made by NASCCMA: (see attached letters) The Committee did not reply to repeated requests. Hal Creel did reply by saying that the Committee did not have the time to hear shipper testimony.

May 1, 1990 Tel. Subcommittee counsel H. Creel - request to testify.
May 3, 1990 FAX letter to Chairman John Breaux - request to testify.
May 7, 1990 FAX letter (State Rep. Isbell) to John Breaux - support for request to testify.
May 7, 1990 Tel. Subcommittee counsel Hal Creel - request to testify.
May 10, 1990 Tel. Subcommittee counsel Hal Creel - request to testify.
May 11, 1990 FAX letter to Chairman John Breaux - request to testify.
May 11, 1990 Tel. Sen. Breaux AA: Wallis Henderson - request to testify.
May 14, 1990 Tel. Sen Breaux AA: Wallis Henderson - request to testify.
May 15, 1990 FAX letter (State Rep. Oshiro) to John Breaux - support for request to testify.

bill. This would lead shippers and others to conclude that the procedures on hearing this bill were tainted.

Further, shipper testimony is important to a hearing on S. 2170 that would amend Sec. 805(a):

(a) Merchant Marine Act, 1936

> Sec. 805(a) recognizes both the need to protect the rights of the shipping public and the rights of that interest to be heard, i.e., all interests shall be permitted to intervene and the Secretary of Transportation, "shall give a HEARING to. . . the intervenors." Shippers and associations of shippers, have in fact, been permitted to intervene and have been permitted to be heard before Section 805(a). e.g. Delta Steamship Lines, 11 SRR 119; Grace Line, Inc., 2 SRR 1101; American Export Lines, Inc., 2 SRR 185.

Further,

> "[I]ntroduction of this service will clearly be in the best interests of Shippers and Consignees. . . This, I consider to be consistent with Section 101 of the 1936 Act, generally, and therefore not prejudicial to the objects and policies of the Act." American Export Lines, Inc. - Sec. 805(a) Application, 2 S.R.R. 185, 186 (MSB, MA 1962)

(b) MarAd and judicial opinions

> The Department [MarAd] would have the responsibility under the "objects and policy" clause to protect the shipping public. Aeron Marine Shipping Co., 22 SRR 1547, 1552 (Sec'y 1984)

and:

> [I]t is important to receive testimony from shippers indicating whether the existing service if fulfilling their needs. . . Delta Steamship Lines - Sec 805(a) Application, 2 MA 322, 324, 10 S.R.R. 610 (Ex. 1968)

(c) Hearings on the Merchant Marine Act, 1936

Congress in 1935-1936 encouraged shippers and associations of shippers to testify at the hearings on legislation on the Merchant Marine Act, 1936. Shippers testified at the hearings: American Cotton Shippers Assoc., National Industrial Traffic League, Southern Pine Assoc., Philadephia Ocean Traffic Bureau.

(d) APL's Sec. 805(a) application

"APL's entry into the trade. . . would result in benefit to the shipping public." American President Lines, Ltd. 805(a) Application, West Coast-Hawaii, MarAd docket S-801, Initial Decision p. 134 (1989).

(e) Shippers would be prejudiced by Congressional Action

S. 2170 would prevent APL from providing service to Hawaii. Benefits to shippers, consignees, and consumers provided by this service would be taken away by Congress without providing shipper interests the opportunity to testify on this bill.

(f) Shippers are best suited to provide information

S. 2170 turns on a provision that "existing service" must be inadequate before Sec. 805(a) permission is granted. Existing service embraces much more than vessels and includes the support given by the shipping public. See Waterman Steamship Corp., 14 SRR 1631, 1635 (MSB 1975)

Further, shippers have to pay for the service, therefore, they are the ones best suited to answer questions about whether the service is "inadequate."

* For the above reasons, shippers were wrongfully precluded from testifying before the Subcommittee on Merchant Marine on S. 2170.

STATEMENT OF ALEX MANDL, CHAIRMAN & CEO, SEA-LAND SERVICE, INC.

Mr. Chairman and members of the Subcommittee:

Sea-Land Service, Inc. (Sea-Land) is the largest U.S.-flag containership carrier in both the domestic and foreign trades. Sea-Land operates a fleet of 38 U.S.-flag vessels and a total of about 70 containerships in common carrier service between 80 ports in 70 countries and territories worldwide.

Sea-Land does not participate in the federal government Operating Differential Subsidy (ODS) program. In addition to its service in the Hawaii trade, Sea-Land also provides service with Alaska, Guam and Puerto Rico. Sea-Land commenced its weekly service to Hawaii in 1987. Consequently, Sea-Land is quite interested in S.2170 and appreciates this opportunity to explain our position on this legislation.

EXPANDED SERVICE TO HAWAII

Before we set forth our views on the bill, however, we wish to inform the Subcommittee of an important new development concerning the containership services to Hawaii. Sea-Land has just announced plans to begin an additional, weekly service to Hawaii. Vessels for this service will be phased in during the fourth quarter of this year. This substantial expansion of containership service to Hawaii by Sea-Land will double Sea-Land's sailing frequency between the mainland and the Hawaiian islands. On May 15th, the Maritime Administration (MarAd) formally notified Sea-Land that it was the successful bidder for the purchase of two U.S.-flag ships from MarAd. The addition of those ships, plus other Sea-Land ships, will permit us to deploy the additional Hawaii service.

Hawaii's consumers will thus enjoy a substantial increase in service frequency, capacity and efficiency. With Sea-Land's worldwide container inventory of over 125,000 units, including more than 14,000 refrigerated vans and about 4,500 units of other specialized equipment, Hawaii's access to quality container service levels will rise to a new high.

ODS REFORM LEGISLATION

As the Subcommittee members are aware, Sea-Land strongly supports U.S. industry efforts to agree upon and achieve enactment of a comprehensive maritime policy reform package. We have worked for years with the other U.S.-flag carriers, maritime labor leaders and government officials to develop a detailed legislative proposal for ODS reform. Some members of this Subcommittee urged us to undertake this arduous endeavor and we have persisted through many months of difficult negotiations.

As this Subcommittee is also aware, the United Shipowners of America completed the latest effort at forming that package just this month. The carriers have respectfully requested the Senate and the House to introduce the bill and conduct hearings at an early date. A tremendous amount of time and energy has been devoted to this legislative effort by Sea-Land and the other U.S.-

flag carriers engaged in foreign commerce. Obviously, the task is far from completion at this stage.

This background is relevant to the Subcommittee's consideration of S.2170. Sea-Land and the other USA members all made a commitment during 1989 to adhere to the ODS reform package and not to support piecemeal legislation. We are bound to honor that commitment. The continued commitment of the USA members to the comprehensive ODS proposal has allowed negotiations to progress to this stage.

It is also noteworthy that Sea-Land has long opposed individual requests for MarAd administrative approvals or authorizations benefitting ODS operators as unfair and undercutting efforts to enact comprehensive ODS reform legislation. This record of opposition at the Maritime Administration includes Sea-Land's continuing opposition to American President Lines' application to serve Hawaii's domestic trade with vessels receiving ODS. Under the ODS reform package, Sea-Land's vessels serving Hawaii would continue to operate unsubsidized.

We are well aware of the complicated nature of the various regulatory and legislative aspects of the ODS system. Those complications are indicative of the dire need for comprehensive reform and modernization of the system.

Finally, with respect to S.2170, Sea-Land is unable to take a position on the bill at this time due to our previous and continuing commitment to a comprehensive approach through the industry ODS reform package. Should the effort to advance ODS reform as a comprehensive package fail, with other foreign commerce carriers seeking separate piecemeal amendments of the law, Sea-Land would naturally re-examine its legislative options, including our position on S.2170.

Again, we are most appreciative of this opportunity to present our views to the Subcommittee.

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August 10, 1990

The Honorable Daniel K. Inouye
Subcommittee on Merchant Marine
Committee on Commerce, Science
  and Transportation
425 Hart Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Inouye,

Enclosed are the United Shipowners of America's answers to additional questions submitted by the Subcommittee on Merchant Marine.

Sincerely,

Mark D. Aspinwall
Government Affairs Representative

Additional Questions from Subcommittee on Merchant Marine Re. S. 2170

Question 1.

With respect to S. 2170, USA has said (letter to DKI) that "if current law needs to be changed it ought to be done prospectively so that those who relied on current law are not injured".

(a) Won't USA's proposal change the law with respect to Section 805, after a domestic carrier (Matson) has invested hundreds of millions of dollars over the past years in reliance on the protection it had under the current Section 805?

(b) Is it therefore logically consistent and fair for USA to complain about S. 2170?

Answer:

USA's proposal does not change the law with respect to Section 805 retroactively but rather, proposes changing it prospectively. The changes, if deemed appropriate by Congress, would apply prospectively, unlike S. 2170 which seeks to not only change the criteria for Section 805 for future applications, but to make the new criteria applicable to all Section 805 approvals granted under existing law.

Question 2

On April 16, I received a letter from USA in which it characterized its efforts as "trying to come to grips with an ODS reform program that would put all U.S.-flag carriers in the international trade on an equal footing and end anachronistic regulations that restrict our ability to compete with foreign flag carriers."

(a) How would grandfathering APL and Sea-Land into the domestic Mainland-Hawaii trade help put U.S.-flag carriers on an equal footing with their foreign competitors? Isn't that what ODS payments are supposed to do?

Answer:

USA's comprehensive ODS reform program is an attempt to narrow the cost differential between the cost of operating a U.S.-flag, U.S. crewed vessel and the operating cost of foreign flag competition in the foreign commerce of the United States. Such a narrowing of this existing cost differential will be one step in the right direction in creating an environment where U.S.-flag carriers will be on a cost parity with the foreign competition and be able to compete fairly.

USA's comprehensive legislative reform proposal is designed to put all U.S.-flag carriers in the international trade on a equal competitive footing and level the playing field vis a vis their foreign-flag competition.

Question 3

The reason why liner operators receive ODS is to put them on an operating parity with their foreign-flag competitors in our international trade. In fact, the Act provides that ODS will not be paid for additional U.S.-flag service in a trade, unless the existing U.S.-flag service is inadequate.

Section 805 permission, on the other hand, is concerned with our domestic trades, and the effect of competition in them between subsidized and unsubsidized U.S.-flag carriers.

Why therefore should a Section 805 issue be considered part of ODS reform, which is intended to put U.S.-flags on operating parity with their competitors in our foreign trades?

Answer:

The interrelationship between the domestic and international shipping business is a fact of life that cannot be ignored. In fact, some of USA's members, while in the international trade, are also in the domestic trade. The 1936 Act, which USA seeks to amend, currently treats both the domestic and international trade.

Question 4

USA and its member operators have been working among themselves on ODS reform proposals for several years. Several of USA's proposals have evolved over that time. One was dated last October, and a subsequent one was dated November 1989. I believe there were earlier ones. In any event, the October 1989 and November 1989 proposals amended Section 805, and all of the USA members agreed among themselves on that provision.

(a) While the USA members consulted one another prior to reaching agreement on Section 805 in the October and November drafts, did USA consult with MATSON simultaneously or at any time before it circulated those drafts?

(b) When was the first time USA offered to discuss Section 805 with Matson? By then wasn't USA's position "set in concrete"?

Answer:

USA did not have final consensus on its reform program until much later. Earlier proposals referred to in the question were no more than that - proposals for internal discussion.

(a) No.

(b) USA offered to discuss Section 805 with Matson in February 1990, and met with Matson officials at the end that month.

USA's position was not "set in concrete" at that time.

Question 5

(a) In its current form, does your ODS reform proposal contemplate ODS for Sea-Land and Crowley?

(b) If it does, wouldn't we have a situation in the Alaska-lower 48 states domestic trade which turns the policy of the Merchant Marine Act "on its head", i.e., two of the three carriers in that domestic trade would be subsidized, and only one would be unsubsidized?

Answer:

(a) Yes.

(b) The situation in the Alaska-lower 48 states domestic trade would not turn the policy of the Merchant Marine Act "on its head". Under USA's proposal neither Sea-Land nor Crowley would receive any subsidy at all with respect to its voyages in the Alaska trade. Those services would continue as they are today - totally non-subsidized.

Question 6

Wouldn't your ODS reform proposal allow Sea-Land and Crowley to become subsidized competitors of TOTE without the current statutory safeguards of Section 805.

Answer:

USA's reform proposal would grandfather Sea-Land and Crowley's existing unsubsidized service in the Alaska trade.

Question 7

Sea-Land is a member of USA. Does it support your statement; and if so, why has its position changed from what it was at the proceeding at MARAD?

Before MARAD, Sea-Land urges that Section 805 requires the Secretary to deny an application if existing service is adequate, and that is what S. 2170 does.

Here, however, USA opposes S. 2170, and also supports a revision to Section 805 in ODS reform which would legislate APL into the Mainland-Hawaii trade.

Answer:

USA's position is unanimous and Sea-Land supports the USA proposed reform package as a comprehensive solution that will aid the entire U.S.-flag merchant marine. USA is not in a position to speak for Sea-Land with regard to its position in the MARAD proceeding.

Question 8

On pp. 2 and 3 of your statement, you refer to the proposed revision of Section 805 which was the subject of agreement among the domestic and subsidized carriers in 1987, as part of an ODS reform proposal which did not materialize. Although I was not the Chairman of the Subcommittee, I followed those negotiations closely.

(a) Is the agreement in USA's proposal the same as the one agreed upon in 1987; and if not, why not, inasmuch as subsidized and domestic carriers agreed on the 1987 proposal?

(b) Isn't it true that the agreement between the domestic carriers and the subsidized carriers was reached after genuine bilateral negotiations. Is the same true with respect to USA's present proposal to amend Section 805 in the context of ODS reform?

Answer:

(a) No. Not all the subsidized and non-subsidized carriers in the foreign commerce were parties to the 1987 agreement. This being said, USA is willing to meet with the domestic carriers again to see if a compromise is possible.

(b) The agreement in question was reached between some, but not all, of the U.S.-flag carriers. Today, all the U.S.-flag carriers in foreign commerce have reached a consensus but have not reached agreement with the domestic carriers. USA is willing to continue the dialogue and hopes that a hearing on our reform package will result in a solution acceptable to all.

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